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Entre-preneur-ship

9 Entrepreneurial Finance and Accounting

Figure 9.1 An advertisement showcasing the features of the iBackPack.

Chapter Outline

Introduction

In 2015, Doug Monahan, the CEO and founder of iBackPack of Texas, Inc., introduced a revolutionary technology package encased in a typical backpack. The iBackPack boasted the capacity to incorporate WiFi/MiFi, a battery system, smart power transfer cables, and a car-charging system—while carrying four notebook computers and their accessories. Monahan promised that the iBackPack would be a "communication hub and corresponding electrical powerhouse for students and business professionals alike."[1] To bring the project to market, iBackPack sought crowdfunding through an Indiegogo campaign that raised $723,395 from 4,041 backers. An additional $76,694 was raised from 252 Kickstarter backers.

In 2016, iBackPack raised over $800,000 to fulfill investors' orders, but the product never materialized. The only update from the company was a Facebook post alluding to issues sourcing "safe" batteries. By 2017, the iBackPack crowdfunding campaign failed to deliver the product promised to its investors.[2],[3] According to an article on the website The Verge in August 2018, the founders of iBackPack were under investigation by the

1 "iBackPack Planning Kickstarter Launch on Black Friday." *Cision PR Newswire*. November 24, 2015. http://www.prnewswire.com/news-releases/ibackpack-planning-kickstarter-launch-on-blackfriday-300183934.html
2 Lewis Leong. "Sorry, iBackPack Backers. You Got Scammed." *Crowdtoolz*. January 9, 2017. http://crowdtoolz.com/sorry-ibackpack-backers-you-got-scammed/
3 Kylie McGovern. "Hundreds Still Waiting for Bulletproof 'iBackPack' Delivery a Year Later." *KXAN*. July 13, 2017. http://kxan.com/2017/07/13/hundreds-still-waiting-for-bulletproof-ibackpack-delivery-a-year-later/

Federal Trade Commission.[4] Although crowdfunding can be a great option for startups, those who abuse the system may find themselves subject to legal action.

9.1 Overview of Entrepreneurial Finance and Accounting Strategies

Learning Objectives

By the end of this section, you will be able to:

- Distinguish between financing and accounting
- Describe common financing strategies for different stages of the company lifecycle: personal savings, personal loans, friends and family, crowdfunding, angel investors, venture capitalists, self-sustaining, private equity sales, and initial public offering
- Explain debt and equity financing and the advantages and disadvantages of each

The case of iBackPack demonstrates that entrepreneurial success is not guaranteed simply because a company can secure funds. **Funds** are the necessary capital to get a business, or idea, off the ground. But funding cannot make up for a lack of experience, poor management, or a product with no viable market. Nonetheless, securing funding is one of the first steps, and a very real requirement, for starting a business.

Let's begin by exploring the financial needs and funding considerations for a simple organization. Imagine that you and your college roommate have decided to start your own band. In the past, you have always played in a school band where the school provided the instruments. Thus, you will need to start by purchasing or leasing your own equipment. You and your roommate begin to identify the basic necessities—guitars, drums, microphones, amplifiers, and so on. In your excitement, you begin browsing for these items online, adding to your shopping cart as you select equipment. It doesn't take you long to realize that even the most basic set of equipment could cost several thousand dollars. Do you have this much money available to make the purchase right now? Do you have other funding resources, such as loans or credit? Should you consider leasing most or all of the instruments and equipment? Would family or friends want to invest in your venture? What are the benefits and risks associated with these funding options?

This same basic inquiry and analysis should be completed as part of every business plan. First, you must determine the basic requirements for starting the business. What kinds of equipment will you need? How much labor and what type of skills? What facilities or locations would you require to make this business a reality? Second, how much do these items cost? If you do not possess an amount of money equal to the total anticipated cost, you will need to determine how to fund the excess amount.

ENTREPRENEUR IN ACTION

Ted Herget and Gearhead Outfitters

Gearhead Outfitters, founded by Ted Herget in 1997 in Jonesboro, Arkansas, is a retail chain that sells outdoor gear for men, women, and children. The company's inventory includes clothing, footwear for hiking and running, camping gear, backpacks, and accessories. Herget fell in love with the outdoor lifestyle while working as a ski instructor in Colorado and wanted to bring that feeling back home to Arkansas. And so, Gearhead was born in a small downtown location in Jonesboro. The company has had

4 Ashley Carman. "The FTC Is Investigating a Crowdfunding Campaign That Disappeared with More than $700K." *The Verge*. August 29, 2018. https://www.theverge.com/circuitbreaker/2018/8/29/17793720/ftc-ibackpack-investigation-indiegogo-kickstarter

great success over the years, expanding to numerous locations in Herget's home state, as well as to locations in Louisiana, Oklahoma, and Missouri.

While Herget knew his industry when starting Gearhead, like many entrepreneurs he faced regulatory and financial issues that were new to him. Several of these issues were related to accounting and the wealth of decision-making information that accounting systems provide. For example, measuring revenue and expenses, providing information about cash flow to potential lenders, analyzing whether profit and positive cash flow is sustainable to allow for expansion, and managing inventory levels. Accounting, or the preparation of financial statements (balance sheet, income statement, and statement of cash flows), provides the mechanism for business owners such as Herget to make fundamentally sound business decisions.

Once a new business plan has been developed or a potential acquisition has been identified, it's time to start thinking about **financing**, which is the process of raising money for an intended purpose. In this case, the purpose is to launch a new business. Typically, those who can provide financing want to be assured that they could, at least potentially, be repaid in a short period of time, which requires a way that investors and business owners can communicate how that financing would happen. This brings us to accounting, which is the system business owners use to summarize, manage, and communicate a business's financial operations and performance. The output of accounting consists of financial statements, discussed in Accounting Basics for Entrepreneurs. Accounting provides a common language that allows business owners to understand and make decisions about their venture that are based on financial data, and enables investors looking at multiple investment options to make easier comparisons and investment decisions.

Entrepreneurial Funding across the Company Lifecycle

An entrepreneur may pursue one or more different types of funding. Identifying the lifecycle stage of the business venture can help entrepreneurs decide which funding opportunities are most appropriate for their situation.

From inception through successful operations, a business's funding grows generally through three stages: seed stage, early stage, and maturity (Figure 9.2). A **seed-stage** company is the earliest point in its lifecycle. It is based on a founder's idea for a new product or service. Nurtured correctly, it will eventually grow into an operational business, much as an acorn can grow into a mighty oak—hence the name "seed" stage. Typically, ventures at this stage are not yet generating revenue, and the founders haven't yet converted their idea into a saleable product. The personal savings of the founder, plus perhaps a few small investments from family members, usually constitute the initial funding of companies at the seed stage. Before an outsider will invest in a business, they will typically expect an entrepreneur to have exhausted what is referred to as F&F financing—friends and family financing—to reduce risk and instill confidence in the business's potential success.

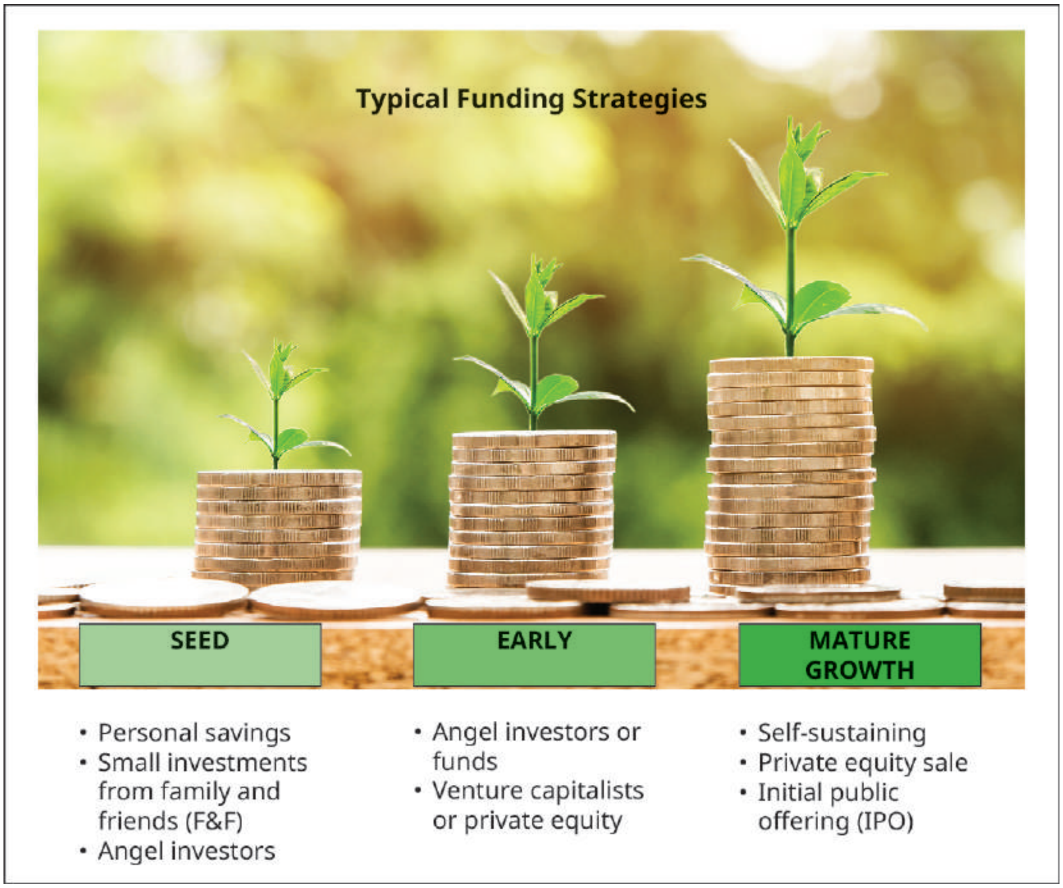

Figure 9.2 Funding strategies can change across different phases of the company lifecycle.

After investments from close personal sources, the business idea may begin to build traction and attract the attention of an angel investor. **Angel investors** are wealthy, private individuals seeking investment options with a greater potential return than is traditionally expected on publicly traded stocks, albeit with much greater risk. For that reason, they must be investors accredited by the federal Securities and Exchange Commission (SEC) and they must meet a net worth or income test. Nonaccredited investors are allowed in certain limited circumstances to invest in security-based crowdfunding for startup companies. Among the investment opportunities angel investors look at are startup and early stage companies. Angel investors and funds have grown rapidly in the past ten years, and angel groups exist in every state.

An **early stage** company has begun development of its product. It may be a technical proof of concept that still requires adjustments before it is customer ready. It may also be a first-generation model of the product that is securing some sales but requires modifications for large-scale production and manufacturing. At this stage, the company's investors may now include a few outsider investors, including venture capitalists.

A **venture capitalist** is an individual or investment firm that specializes in funding early stage companies. Venture capitalists differ from angel investors in two ways. First, a venture capital firm typically operates as a full-time active investment business, whereas an angel investor may be a retired executive or business owner with significant savings to invest. Additionally, venture capital firms operate at a higher level of sophistication, often specializing in certain industries and with the ability to leverage industry expertise to invest with more know-how. Typically, venture capitalists will invest higher amounts than angel investors, although this trend may be shifting as larger angel groups and "super angels" begin to invest in venture rounds.

Private equity investment is a rapidly growing sector and generally invests later than venture capitalists. Private equity investors either take a public company private or invest in private companies (hence the term “private equity”). The ultimate goals of private equity investors are generally taking a private company public through an initial public offering (IPO) or by adding debt or equity to the company’s balance sheet, and helping it improve sales and/or profits in order to sell it to a larger company in its sector.

Companies in the **mature stage** have reached commercial viability. They are operating in the manner described in the business plan: providing value to customers, generating sales, and collecting customer payments in a timely manner. Companies at this stage should be self-sufficient, requiring little to no outside investment to maintain current operations. For a product company, this means manufacturing a product at scale, that is, in very large volumes. For a software company or app provider, this means generating sales of the software or subscriptions under an SaaS model (Software as a Service) and possibly securing advertising revenue from access to the user base.

Companies at the mature stage have different financing needs from those in the previous two stages, where the focus was on building the product and creating a sales/manufacturing infrastructure. Mature companies have reached a consistent level of sales but may seek to expand into new markets or regions. Typically, this requires significant investment because the proposed expansion can often mirror the present level of operations. That is to say, an expansion at this level may result in doubling the size of the business. To access this amount of capital, mature companies may consider selling a portion of the company, either to a private equity group or through an IPO.

An **initial public offering (IPO)** occurs the first time a company offers ownership shares for sale on a public stock exchange, such as the New York Stock Exchange. Before a company executes an IPO, it is considered to be privately held, usually by its founders and other private investors. Once the shares are available to the general public through a stock exchange, the company is considered to be publicly held. This process typically involves an investment banking firm that will guide the company. Investment bankers will solicit institutional investors, such as State Street or Goldman Sachs, which will in turn sell those shares to individual investors. The investment banking firm typically takes a percentage of the funds raised as its fee. The benefit of an IPO is that the company gains access to a massive audience of potential investors. The downside is that the owners give up more ownership in the business and are also subject to many costly regulatory requirements. The IPO process is highly regulated by the SEC, which requires companies to provide comprehensive information up front to potential investors before completing the IPO. These publicly traded companies must also publish quarterly financial statements, which are required to be audited by an independent accounting firm. Although there are benefits to an IPO for later-stage companies, it can be very costly both at the start and on an ongoing basis. Another risk is that if the company does not meet investors’ expectations, the value of the company can decline, which can hinder its future growth options.

Thus, a business’s lifecycle stage greatly influences its funding strategies and so does its industry. Different types of industries have different financing needs and opportunities. For example, if you were interested in opening a pizzeria, you would need a physical location, pizza ovens, and furniture so customers could dine there. These requirements translate into monthly rent on a restaurant location and the purchase of physical assets: ovens and furniture. This type of business requires a significantly higher investment in physical equipment than would a service business, such as a website development firm. A website developer could work from home and potentially begin a business with very little investment in physical resources but with a significant investment of their own time. Essentially, the web developer’s initial funding requirement would simply be several months’ worth of living expenses until the business is self-sufficient.

Once we understand where a business is in its lifecycle and which industry it operates in, we can get a sense of its funding requirements. Business owners can acquire funding through different avenues, each with its own advantages and disadvantages, which we will explore in Special Funding Strategies.

WORK IT OUT

Venture Capitalists

Consider this statement from John Mackey, the CEO of Whole Foods Market: "Venture capitalists are like hitchhikers—hitchhikers with credit cards—and as long as you take them where they want to go, they'll pay for the gas. But, if you don't . . . they will try to hijack the car and they will hire a new driver and throw you out on the road." He spoke on the NPR podcast *How I Built This*.[5]

How would you feel if the investors in the company you founded started trying to wrest control of the organization from you? What steps would you take to prepare for this situation?

Types of Financing

Although many types of individuals and organizations can provide funds to a business, these funds typically fall into two main categories: debt and equity financing (Table 9.1). Entrepreneurs should consider the advantages and disadvantages of each type as they determine which sources to pursue in support of their venture's immediate and long-term goals.

Debt vs. Equity Financing

	Debt Financing	Equity Financing
Ownership	Lender does not own stake in company	Lender owns stake in company
Cash	Requires early and regular cash outflow	No immediate cash outflow

Table 9.1

Debt Financing

Debt financing is the process of borrowing funds from another party. Ultimately, this money must be repaid to the lender, usually with interest (the fee for borrowing someone else's money). Debt financing may be secured from many sources: banks, credit cards, or family and friends, to name a few. The maturity date of the debt (when it must be repaid in full), the payment amounts and schedule over the period from securement to maturity, and the interest rate can vary widely among loans and sources. You should weigh all of these elements when considering financing.

5 "Whole Foods Market: John Mackey." *How I Built This* (NPR Podcast). May 15, 2017. https://www.npr.org/2017/06/30/527979061/whole-foods-market-john-mackey

The advantage of debt financing is that the debtor pays back a specific amount. When repaid, the creditor releases all claims to its ownership in the business. The disadvantage is that repayment of the loan typically begins immediately or after a short grace period, so the startup is faced with a fairly quick cash outflow requirement, which can be challenging.

One source of debt financing for entrepreneurs is the Small Business Administration (SBA), a government agency founded as part of the Small Business Act of 1963, whose mission is to "aid, counsel, assist and protect, insofar as is possible, the interests of small business concerns."[6] The SBA partners with lending institutions such as banks and credit unions to guarantee loans for small businesses. The SBA typically guarantees up to 85 percent of the amount loaned. Whereas banks are traditionally wary of lending to new businesses because they are unproven, the SBA guarantee takes on some of the risk that the bank would normally be exposed to, providing more incentive to the lending institution to finance an entrepreneurial venture.

To illustrate an SBA loan, let's consider the 7(a) Small Loan program. Loans backed by the SBA typically fall into one of two categories: working capital and fixed assets. **Working capital** is simply the funds a business has available for day-to-day operations. If a business has only enough money to pay bills that are currently due, that means it has no working capital—a precarious position for a business to be in. Thus, a business in this position may want to secure a loan to help see it through leaner times. **Fixed assets** are major purchases—land, buildings, equipment, and so on. The amounts required for fixed assets would be significantly higher than a working capital loan, which might cover just a few months' expenses. As we will see, loan requirements made under the 7(a) Small Loan program are based on loan amounts.

For loans over $25,000, the SBA requires lenders to demand collateral. **Collateral** is something of value that a business owner pledges to secure a loan, meaning that the bank has something to take if the owner cannot repay the loan. Thus, in approving a larger loan, a bank might ask you to offer your home or other investments to secure the loan. In a real estate loan, the property you are buying is the collateral. In a way, loans for larger purchases can be less risky for a bank, but this can vary widely from property to property. A loan that does not require collateral is referred to as unsecured.

To see how a business owner might use an SBA loan, let's return to the example of a pizzeria. Not all businesses own the buildings where they operate; in fact, a great many businesses simply rent their space from a landlord. In this case, a smaller loan would be needed than if the business owner were buying a building. If the prospective pizzeria owner could identify a location available for rent that had previously been a restaurant, they might need only to make superficial improvements before opening to customers. This is a case where the smaller, collateral-free type of SBA loan would make sense. Some of the funds would be allocated for improvements, such as fresh paint, furniture, and signage. The rest could be used to pay employees or rent until the pizzeria has sufficient customer sales to cover costs.

In addition to smaller loans, this SBA program also allows for loans up to $350,000. Above the $25,000 threshold, the lending bank must follow its own established collateral procedures. It can be difficult for a new business to provide collateral for a larger loan if it does not have significant assets to secure the loan. For this reason, many SBA loans include the purchase of real estate. Real estate tends to be readily accepted as collateral because it cannot be moved and holds it value from year to year. For the pizzeria, an aspiring business owner could take advantage of this higher level of lending in a situation where the business is buying the property where the pizzeria will be. In this case, the majority of loan proceeds will likely go toward the purchase price of the property. Both the high and low tiers of the SBA loan program are examples of debt financing. In Special Funding Strategies, we will look at how debt financing differs from equity financing.

6 Small Business Administration (SBA). "Mission." n.d. https://www.sba.gov/about-sba/what-we-do/authority

Equity Financing

In terms of investment opportunities, equity investments are those that involve purchasing an ownership stake in a company, usually through shares of stock in a corporation. Unlike debts that will be repaid and thus provide closure to the investment, **equity financing** is financing provided in exchange for part ownership in the business. Like debt financing, equity financing can come from many different sources, including friends and family, or more sophisticated investors. You may have seen this type of financing on the TV show *Shark Tank*. Contestants on the series pitch a new business idea in order to raise money to start or expand their business. If the “sharks” (investors) want to invest in the idea, they will make an offer in exchange for an ownership stake. For example, they might offer to give the entrepreneur $200,000 for a return of 40 percent ownership of the business.

The advantage of equity financing is that there is no immediate cash flow requirement to repay the funds, as there is with debt financing. The drawback of equity financing is that the investor in our example is entitled to 40 percent of the profits for all future years unless the business owner repurchases the ownership interest, typically at a much higher **valuation**—an estimate of worth, usually described in relation to the price an investor would pay to acquire the entire company.

This is illustrated in the real-life example of the ride-sharing company Uber. One of the early investors in the company was Benchmark Capital. In the initial round of (venture capital) financing, Benchmark invested $12 million in Uber in exchange for stock. That stock, as of its IPO date in May 2019, was valued at over $6 billion, which is the price that the founders would have to pay to get Benchmark’s share back.

Some financing sources are neither debt nor equity, such as gifts from family members, funds from crowdfunding websites such as Kickstarter, and grants from governments, trusts, or individuals. The advantages and disadvantages of these sources are discussed in Special Funding Strategies.

ARE YOU READY?

Researching Venture Capital Sources

Perform an internet search for venture capital firms. Review their websites to determine what specific industries each firm invests in. Would your idea for a business fit with any of these firms? What are some aspects that would indicate a good fit?

9.2 Special Funding Strategies

Learning Objectives

By the end of this section, you will be able to:

- Identify funding strategies used by charitable organizations
- Describe financing opportunities available to startups
- Define bootstrapping
- Describe the advantages and disadvantages of bootstrapping

It’s important to recognize that not all startups are Silicon Valley tech companies. These companies create high-profile products, such as applications and websites, which can take years to become profitable or even generate revenue. Much more common are the small businesses founded every day by entrepreneurs seeking to create value in their local communities. Moreover, not all startups are founded with a profit motive in mind.

Charitable organizations, or certain nonprofit companies, are often founded for altruistic purposes, such as advancing the arts, education, and science; protecting the natural environment; providing disaster relief; and defending human rights (Table 9.2).

Charitable Missions and Example Organizations

Mission	Examples
Advance education	Teach for America, Khan Academy
Protect the natural environment	Sierra Club, Wildlife Conservation Society
Defend human rights	Amnesty International, Human Rights Watch
Provide disaster relief	American Red Cross
Support the arts	Metropolitan Museum of Art, Americans for the Arts

Table 9.2

These goals supersede the profit motive that a traditional company would have. As a result, the funding strategies of these enterprises often differ quite dramatically from those of standard for-profit businesses. Without the emphasis on profit, it can be difficult to provide for the cost of ongoing operations. Thus, these organizations must develop a **sustainable strategy**—one that can maintain the organization’s financial stability.

In the United States, such organizations can qualify for **tax-exempt status**, meaning that if there is a profit from operations, it is not typically subject to taxes. Organizations seeking this exemption must apply to the Internal Revenue Service for tax-exempt status and provide information about what kind of mission the organization carries out—charitable, scientific, educational, and so on.

Consider a museum. What is its purpose? Traditional companies provide a product or service to their customers in exchange for payment, and typically fill a need their customers have. A grocery store sells food because human beings need to eat food to survive. Although viewing paintings and sculptures is not a physical requirement for life, this experience arguably enriches our lives and helps educate and shape our society. That is why museums are founded. Consider the original mission statement of the Metropolitan Museum of Art (commonly known as the “Met”) in New York City (Figure 9.3).[7]

7 Charter of The Metropolitan Museum of Art, State of New York, Laws of 1870, Chapter 197, passed April 13, 1870, and amended L.1898, Ch. 34; L. 1908, Ch. 219. https://www.metmuseum.org/about-the-met

NEW YORK'S METROPOLITAN MUSEUM OF ART MISSION STATEMENT

To be located in the City of New York, for the purpose of establishing and maintaining in said city a Museum and library of art, of encouraging and developing the study of the fine arts, and the application of arts to manufacture and practical life, of advancing the general knowledge of kindred subjects, and, to that end, of furnishing popular instruction.

Figure 9.3 The mission statement of New York's Metropolitan Museum of Art summarizes the purpose of this entity. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

This is a different goal than that of most small businesses (providing a product or service in exchange for a profit) and, as a result, requires different financing strategies, such as a combination of program services, donations, and grants.

LINK TO LEARNING

Go to the Internal Revenue Service's website and look at the most recently updated Pub 334 Tax Guide for Small Business (https://openstax.org/l/52IRSPub334) to learn more about the rules for income tax preparation for a small business.

Program Services

Program services are the basic offerings that a nonprofit organization provides that result in revenue, although not typically enough to cover the overall cost of running the organization. These services most closely resemble the customer interactions of a traditional business. The organization provides a product or service in exchange for a customer's money.

In our museum example, program services could take a few different forms. First, the museum likely charges a fee for admission to view the artwork and artifacts. The individual ticket price multiplied by the number of museum visitors equals the museum's ticket revenue. An established museum will have a good sense of how many visitors it has on average and can use these data to create a budget.

Another source of program service revenue for a museum could take the form of hands-on educational activities or events with guest speakers or presenters. Often museums will host local artists, or their own employees might conduct art classes or special-topic tours. These events and activities typically have a charge (revenue) beyond the regular admission cost.

Despite these revenue-generating activities, nonprofit organizations still face many funding challenges in covering all the operating costs of a normal business, such as employee wages, facility costs, and advertising. Thus, they need many different sources of income. To illustrate, the Met's 2018 program service income only made up 2.3 percent of its total revenue for the year.[8]

8 Calculated from the 2018 IRS Form 990 available on the Met's website. https://www.metmuseum.org/-/media/files/about-the-met/990-forms/2017-irs-form-990-for-fy2018.pdf

Donations

One benefit to a business with a charitable mission is inherent public support, which can foster community involvement above and beyond patronage. For nonprofits, this can translate into a willingness to donate money to the organization. A **donation** is a financial gift with no expectation of repayment or receiving anything in return. A traditional business must provide something valuable to create a customer exchange: Their customers demand value in exchange for their hard-earned money.

The benefactors of a charitable organization want to help further the mission of the organization. This type of entity—whether it’s a museum, a hospital, or the Red Cross—relies on the goodwill of community supporters. For the Met, with such a low percentage of revenue generated by program services, it’s clear that donations and charitable gifts are vital to the organization’s **financial viability**.

Grants

Another source of funding for nonprofit organizations is grants. A **grant** is a financial gift given for a specific purpose by a government agency or a charitable organization such as the Bill and Melinda Gates Foundation. Like a donation, a grant does not have to be repaid. Unlike with donations, both nonprofit and for-profit organizations can compete for grants. Whereas donations are typically given without restriction to offset the general operating expenses of the organization, grants often specify how the funds are to be used. Most grant-providing entities have an agenda or purpose behind their funding. For example, the National Institutes of Health (NIH) provides grants “to support the advancement of the NIH mission to enhance health, extend healthy lives, and reduce the burdens of illness and disability.”[9] This federal organization invests over $32 billion annually for medical research.

Grants can be very competitive, requiring a rigorous application process. Usually, multiple organizations apply for the same grant; the organization issuing the grant reviews the many competing applications to make its selection. Grantees generally must submit audited financial statements and are required to update the grantor subsequent to the grant award to ensure proper intended use. The NIH awards almost 50,000 grants annually, most of which are competitive. Although that is an enormous number of projects to fund, only 20 percent of applications submitted to the NIH in 2018 actually were accepted.[10] In other words, the NIH rejected four out of every five applications. For entrepreneurs, this means that when you identify a grant that is specific to your organization’s mission, you should weigh your chances of being awarded the grant when considering it as part of your funding strategy.

To understand grants in practice, let’s further examine the NIH. The NIH Small Grant Program provides funds for activities such as the development of new research technology. This specific grant can be awarded for up to a two-year period, with funds of up to $50,000 in direct costs per year. A grant like this could provide vital support to a nonprofit startup.

Some business ventures fall somewhere between organizations completely committed to charitable work and traditional small businesses with entrepreneurs focused on social entrepreneurship. Social entrepreneurs develop products and services as solutions to societal problems. For example, the TOMS shoe company was able to create a business model through which the company gives one pair of shoes to children in need in foreign countries for every pair of shoes that a customer purchases. This practice pioneered what they refer to as “One for One.”[11]

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9 National Institutes of Health. “Grant Basics.” February 21, 2017. https://grants.nih.gov/grants/grant_basics.htm
10 National Institutes of Health. “Annual Snapshot.” n.d. https://nexus.od.nih.gov/all/2019/03/13/nih-annual-snapshot-fy-2018-by-the-numbers/

The company’s website describes the origins of both the company and this model, which are based on the experiences of its founder, Blake Mycoskie (Figure 9.4).[12]

TOMS ORIGIN STORY

While traveling in Argentina in 2006, Blake witnessed the hardships faced by children growing up without shoes. His solution to the problem was simple, yet revolutionary: to create a for-profit business that was sustainable and not reliant on donations. Blake's vision soon turned into the simple business idea that provided the powerful foundation for TOMS.

Figure 9.4 The TOMS origin story provides an example of social entrepreneurship. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Social entrepreneurship offers the ability to effect positive change in the world without simply relying on donations. It pairs a profitable, sustainable business model with a good cause. This combination often creates positive word of mouth. It gives potential customers a good feeling about the product beyond just its style or function.

WHAT CAN YOU DO?

Social Entrepreneurship

Like the founder of TOMS, sometimes in our everyday life, we are presented with an opportunity to help people. We may even find out that we’re not alone in this desire to help. What opportunities to help—individuals, society, or environment—do you see in your own community? What are some ways that you could raise awareness around this issue?

No-Loan Finance Strategies

As you’ve learned, many startups come into being through the extensive use of debt. Although borrowing is a legitimate source of funding, it can be risky, especially if the entrepreneur is personally responsible for repayment. In practice, some entrepreneurs max out credit cards, take out home-equity loans against their primary residences, or secure other high-interest personal loans. If the entrepreneur fails to repay the loans, the result can be repossession of equipment, home foreclosure, and other legal action.

We now examine funding strategies attractive to many startups that do not require going into debt or exchanging ownership of the business for financial support (debt and equity financing). The financing methods described here are more creative funding strategies, including crowdfunding, bartering, and other methods.

11 TOMS. “One for One.” n.d. https://www.toms.com/improving-lives
12 TOMS. “Blake Mycoskie.” n.d. http://www.toms.com/blakes-bio

Crowdfunding

Recall the story of iBackPack. This venture was originally funded by contributions through Indiegogo and Kickstarter. These websites are a form of **crowdfunding**, which involves collecting small sums of money from a large number of people. The people who contribute money are typically referred to as backers because they are backing the project or supporting the business idea.

Browsing these crowdfunding websites, you will see many different kinds of ventures seeking financial backing—from creating new board games to opening donut cafes. Each project identifies an overall specific funding goal in terms of a dollar amount. Some crowdfunding websites, such as Kickstarter, implement an “all or nothing” model in which projects do not receive any funds unless their overall funding goal is met. The amount can be exceeded, but if it is not met, the project receives nothing. For an entrepreneur utilizing this resource, selecting an attainable funding goal must be a core part of their strategy. The funding goal must also be appropriate to the scale of the project. For example, setting a goal of $50,000 may be reasonable for launching a food truck (which could be a prototype for a full restaurant), but it is a mere fraction of the cost of constructing an entire table-service restaurant, which would come closer to $750,000. An entrepreneur seeking to enter the culinary world should consider which target would be most achievable as well as most beneficial in meeting both short- and long-term goals. Also, remember that meeting the funding goal does not ensure success of the business, as was the case with iBackPack.

Entrepreneurs vying for crowdfunding usually employ some common tactics. First, they often post an introductory video that explains the project goal and the specific value proposition. (For example, a chef might seek $75,000 to open a food truck specializing in a relatively unknown cuisine.) Second, the entrepreneur provides a more detailed written summary of the project, often including specific items that the funding will pay for, such as $50,000 for a vehicle, $10,000 for graphic design and vehicle decals, and $15,000 for kitchen equipment for the truck. Last is the reward structure, which is what entices visitors to the site to fund the project, offering a return beyond their own passion for the venture. The reward structure establishes different levels of funding and ties a specific reward to each level. For example, for a contribution of $5, the chef might thank the backer on social media; for $25, the backer would get a t-shirt and a hat featuring the food truck’s logo; for $100, the backer would get five free meals when the food truck opens. Fees for these crowdfunding sites vary from 5 to 8 percent. Kickstarter now requires physical products or prototypes for some startups, as well as a short video to help represent and “sell” the product.

Although this financing source offers a lot of flexibility, businesses utilizing crowdfunding can run into trouble. Certain funding levels and rewards may have limits. For example, a reward structure might offer backers contributing $1,000 a trip to the grand opening of the food truck, including airfare and hotel. These top-tier rewards can generate a lot of excitement, but the expense of flying people around the country and providing accommodations could become unmanageable. One research study stated that 84 percent of Kickstarter’s top projects delivered their rewards late.[13]

The advantage of crowdfunding is that the business receives cash up front to launch. The down side is that the reward requires a future payment to the backers. This payment may be in the form of branded merchandise, meals, or even events or travel, so it is important for entrepreneurs to set aside part of the investment money to fund the rewards. Depending solely on generating the reward funds out of future sales is a risk that might result in upsetting the very fans who made the business possible. Since crowdfunding is managed online, another risk is upsetting the project’s vocal supporters. Crowdfunding usually provides only a “kick start” for a

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13 Francesco Schiavone. “Incompetence and Managerial Problems Delaying Reward Delivery in Crowdfunding.” *Journal of Innovation and Economics Management*. February 2017. https://www.cairn.info/revue-journal-of-innovation-economics-2017-2-page-185.htm

startup, so most seed-stage companies will need additional funding from other sources to get to their first commercial launch.

Although social media can backfire, entrepreneurs can take advantage of benefits too. Crowdfunding can allow an entrepreneur to build a community around a product before it is even sold. Like-minded fans of a product can connect with each other over the internet, in the feedback section of a website, or in shared social media posts. Additionally, backers of a project can become cheerleaders for it by sharing the idea—and their enthusiasm for it—with friends, family, and coworkers. Word-of-mouth marketing can lead to more backers or future customers after launch.

Dozens of crowdfunding portals exist, including WeFunder, SeedInvest, Kickstarter, and Crowdcube. Current SEC guidelines[14] for issuing and investing limits granted for Title III Crowdfunding include:

- A company can raise up to $1 million in aggregate through crowdfunding offerings over a twelve-month period
- Over a twelve-month period, individual investors can invest in the aggregate across all crowdfunding offerings up to:
    - $2,000 or 5 percent of the unaccredited investors net worth or yearly income if they make less than $100,000/year
    - 10 percent of the lesser of their annual income or net worth, if both their annual income and net worth are equal to or more than $100,000

ARE YOU READY?

Kickstarter

Visit the Kickstarter website at https://www.kickstarter.com/ and review a few projects. What did they do well in the video pitch? What unique rewards did they offer? How would you implement a Kickstarter page for your own business idea?

Bartering

Startup companies often don’t have a lot of cash assets on hand to spend, but they often have offerings that can provide value to other businesses. **Bartering** is a system of exchanging goods or services for other goods or services instead of for money. Let’s consider the case of Shanti, a website designer who wants to start a business. She may want to have her business formally incorporated or may require other legal help, such as review of standard contracts. Hiring a lawyer outright for these services can be costly, but what if the lawyer needed something that a website designer could provide?

Whether the lawyer has just started his own business or has been established for several years, he may need a website created or have an old website redesigned and updated. This website overhaul could prove costly for the lawyer. But what if there were a way that both the lawyer and the web designer could get what they wanted with a resulting net cost of zero dollars? Bartering can achieve this. It should be noted that there are accounting and tax implications involved with bartering that can prevent a net zero offset of costs.

14 Securities and Exchange Commission. “Crowdfunding.” n.d. https://www.sec.gov/rules/final/2015/33-9974.pdf

In a barter scenario, Shanti could create a website for the lawyer at the expense only of her time, which in the startup phase is often more abundant than actual cash. The lawyer could provide incorporation services or contract review in exchange, requiring no cash outlay. For many entrepreneurs, this type of exchange is appealing and enables them to meet business needs at a lower perceived cost. Although more mature firms can also use bartering, the opportunity cost is much higher. If a mature company is unable to take on a new paying client because it is doing too much free (barter) work, it may lose out on future revenue, which could potentially be a big loss. Startups, in contrast, often have excess capacity while they develop a customer base, so taking on barter work is often a low-risk, beneficial funding strategy.

Other No-Loan Funding Options

Beyond crowdfunding and bartering, startups have other options to help them get off the ground, such as funding competitions and pre-orders (Figure 9.5). Many organizations hold entrepreneurial finance contests provide financial awards to the winners. These prize funds can be used as seed money to start a new venture. For example, the New York City Public Library holds an annual business plan competition called the New York StartUP! Business Plan Competition.[15] Applicants must complete an orientation session, attend workshops that develop skills related to the creation of a business plan, and submit a complete business plan. The first-place award yields $15,000 in prize money, which can be a great start toward turning an entrepreneurial idea into a business reality.

Another way for startups to gain financial traction is to solicit pre-orders. Consider the launch of a new book or video game. Retail stores will often solicit pre-orders, which are advance purchases of the product. Customers pay for the desired item before they even have access. For example, the entrepreneur Mitchell Harper raised $248,000 in funds before his product launched.[16] This approach is not limited to existing, well-known franchises—startups can use it as well. Although established novel and video game franchises have big fan bases and often large advertising budgets, startups can still find effective strategies in this space.

15 New York Public Library. "New York Startup! 2019 Business Plan Competition." n.d. https://www.nypl.org/help/services/startup
16 Mitchell Harper. "How I Got $248,000 in Pre-Orders before I Even Had a Product." *Medium*. November 25, 2015. https://blog.markgrowth.com/how-i-got-248-000-in-pre-orders-before-i-even-had-a-product-b4080a3eb8ae

Figure 9.5 Entrepreneurs can explore a variety of no-loan funding options. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Companies with a prototype model of their product or a first manufacturing run can showcase the new product to potential customers, who may be interested enough to place an order. The company can use the funds received from these pre-orders to pay for the inventory. In addition to having sales staff make sales calls, new companies can attend trade shows and exhibitions to garner interest in the product. Many new products are launched in this fashion because it allows access to many potential customers in one place.

Why Bootstrapping Hurts, Then Helps

The process of self-funding a company is typically referred to as **bootstrapping**, based on the old adage that urges us to "pull ourselves up by our bootstraps." It describes a funding strategy that seeks to optimize use of personal funds and other creative strategies (such as bartering) to minimize cash outflows. In recent years, this strategy has been the fodder for shows like *Shark Tank*. These shows may make entrepreneurs think that being on TV is glamorous, or the shows may glorify the financial backing of millionaires and billionaires. We have seen that for many entrepreneurs, the reality is that there are drawbacks to bringing in outside investors to launch your venture. These drawbacks include loss of future profits and possible loss of control of the company, among others. Potential business owners must weigh the advantages and disadvantages—both short and long term—for funding their specific dream.

You’ve learned about financing strategies predicated on finding a willing investor or lender, but many small businesses simply don’t have access to large amounts, or any amount, of capital. In these cases, aspiring business owners need lean business strategies that will yield the greatest benefit.

Bootstrapping requires entrepreneurs to shed any preconceived notions of the popular-culture image of startups. Most startups don’t have trendy downtown offices, foosball tables, or personal chefs. Bootstrapping reality looks more like late nights spent clipping coupons. It involves scrutinizing potential expenses and whether each cost is really worth the investment. It can be a difficult and trying process, but without any angel investors or wealthy family backers, bootstrapping is often an entrepreneur’s only option. The good news is that this approach can pay substantial dividends in the long run.

The Basics of Bootstrapping

When entrepreneurs risk their life savings, they must stretch every dollar as far as possible. Having a limited amount of capital to work with requires optimizing creative strategies to get the business launched and keep it afloat. This creativity applies to bringing customers and sales in the door as well as to managing expenses.

Understanding the ongoing costs of the business is key. In an interview on NPR’s show *How I Built This*, Barbara Corcoran, one of the investors on *Shark Tank*, shares her humble beginnings in real estate brokerage.[17] One of things she touches on is being constantly aware of how long her money would last, given her monthly expenses. If she had $10,000 in the bank and the cost of her rent and employees was $2,500 per month, she knew that the money would last her four months. Such constant information and vigilance are required when bootstrapping a business for success.

Employee costs are typically one of the largest expenses facing a business. Hiring traditional full-time employees can be costly; onboarding them too early can be fatal to a business’s bottom line. Creative approaches to minimizing labor costs can be enormously helpful. One strategy for controlling these costs is utilizing independent contractors (freelancers) and other part-time employees. They do not work full time for the business and may serve other companies as well. Their compensation is generally lower than that of a full-time, salaried employee, often in part because these positions do not usually come with any benefits, such as health insurance or paid time off. Using these workers to fill resource needs can help minimize costs. Once operations have begun to stabilize, it may be possible and ideal to offer full-time employment to these individuals.

Marketing is another key area for new business investment, but billboards, web ads, TV ads, and radio spots can be expensive. TV and radio ads can also be ineffective if they are aired during low-volume times, which is typically all that startups with lower budgets can afford. Fortunately, there are many low- or no-cost marking opportunities, such as word-of-mouth marketing. Doing a good job for one customer can easily lead to referrals for more business. Some social media efforts can also provide a strong return for minimal investment, although typically it is nearly impossible to gauge an effort’s potential impact or success.

A new enterprise that is bootstrapping must also carefully manage operational expenses. At the beginning of operations, an entrepreneur can often minimize unnecessary expenses—even if that means forgoing an actual business location. Working out of a home office or a co-working space (such as WeWork or Impact Hub) can lead to significant savings. Renting office space can cost hundreds or thousands of dollars a month, whereas a

17 National Public Radio. “Real Estate Mogul: Barbara Corcoran.” *How I Built This*. May 14, 2018. https://www.npr.org/templates/transcript/transcript.php?storyId=610491305

home office typically requires no additional investment. Depending on the location, co-working spaces can provide a single workspace and technology access for as little as $50 to $100 per month, yielding substantial savings over a dedicated office suite. In larger cities, or in locations with more amenities, the monthly costs can run between $100 and $500 per month.

The Boston Beer Company, which today produces the Samuel Adams line of beers, provides a classic example of minimizing these costs in its early days. When this company first started, it owned no office space—or even a brewery. It employed other breweries as contract brewers to manufacture its beer. Its founder, Jim Koch, invested most of his time in selling to bars and restaurants, working from his car and phone booths. (This was during the 1980s.) His lean strategy was a successful application of the bootstrapping mindset. From its humble beginnings, the Boston Beer Company has become one of the largest American-owned breweries—ranked second based on 2018 sales volume by the Brewers Association.[18] Whereas traditional thinking may dictate that a company must have an official office or headquarters, a bootstrapping mindset evaluates what the space would be used for and the trade-offs for its cost.

How Bootstrapping Hurts

The process of bootstrapping is not an easy one. It is fraught with tight budgeting and sacrifice, which can take its toll on an entrepreneur. One of the simplest bootstrapping strategies is to start a business by **moonlighting**, or treating your business venture as a second job. Employing this strategy, the entrepreneur continues to work at their regular job, say from 9:00–5:00, and then dedicates the rest of the evening and weekends to working on the business. Whereas this strategy has the obvious benefit of maintaining a comfortable level of income, this approach has a few drawbacks (Table 9.3). Moonlighting entrepreneurs cannot dedicate 100 percent of their time and energy to their new business. The time they can dedicate to it may be less efficient. After working all day at another job, a person may feel tired or burned out, so it can be difficult to change gears and press forward with full productivity.

In addition to the exhausting time investment, moonlighting can exact tolls on personal relationships. This strategy is easiest when an entrepreneur is in a life stage with few commitments. It may have an adverse effect on friendships, but in other life stages, this impact can be more significant. For example, it can detract from relationships with a partner/spouse or children, in both a decrease in focus/investment in these relationships and day-to-day challenges in work-life balance and household management for all affected. Additionally, at some point, to attract serious investors, a founder will have commit to the project full time.

Bootstrapping Advantages and Disadvantages

Advantages	Disadvantages
• No ownership given up • Forces creative solutions • Keeping costs low fuels growth	• Slow to start • Less glamorous • Owner must make personal sacrifices

Table 9.3

18 Brewers Association. “Brewers Association Unveils 2018 Rankings of Top US Brewing Companies.” 2019. https://www.brewbound.com/news/brewers-association-unveils-2018-rankings-of-top-us-brewing-companies

Other bootstrapping strategies include negotiating the terms for payments on expenses. Often when businesses sell to other businesses, the vendor allows the customer to buy on **credit**. This means that the buyer does not have to pay at the time of purchase. Although retail customers are required to pay at the register during checkout, purchases between businesses can work on different terms, sometimes extended up to thirty, sixty, or ninety days. This extra time to pay for purchases can be a real advantage for businesses. When a business buys inventory on credit, it has the opportunity to begin selling it before it has even paid for it. For example, a clothing retailer could sell its product in stores or online, and receive cash before it had to pay its vendors. Unfortunately, when a business's cash becomes tight, an ethical dilemma can arise. When a business has more bills to pay than money to pay them with, the owner will need to make tough decisions. It can be easy to forget about or ignore amounts due to vendors, but this problem is compounded when it occurs with more and more vendors. Ultimately, it can get to the point where vendors will no longer sell to you on credit, or even at all. When a company can no longer buy inventory to sell to customers, it won't be long until it's out of business. An ethical entrepreneur will be alert to this concern and resolve it with aboveboard business decisions.

How Bootstrapping Helps

Although bootstrapping can be painful in the early years of a business, it yields significant benefits for the business owner in the long term. One of the most valued benefits of bootstrapping a business is the fact that the founder can maintain control of the company and typically retain 100 percent ownership. Although it can be easy to give up ownership in an idea because ideas come freely and don't require financial sacrifice, entrepreneurs who accept an equity financing opportunity and give up a significant portion of ownership of the business may not realize the potential detrimental outcomes. What seems glamorous on *Shark Tank* may cost a business owner more control than desired. Once you give up any amount of equity in a business, it can be difficult or expensive to get it back. Once the deal is accepted, the investor is entitled to that percentage of the profit every year the company is in business, even if that person never lifts a finger to support the enterprise. Entrepreneurs usually make those financing deals because of the benefits of the money and access to the investor's contacts. It's unlikely that Mark Cuban is going to roll up his sleeves in your food truck when things get tough. If you can avoid outside financing, you will maintain complete control and full ownership of the business, and you should weigh this benefit in your financing decisions.

Another benefit of bootstrapping is avoiding taking on debt. Whether it's in the form of credit cards or personal loans, repayment of debt can take a serious toll on any business and can be especially burdensome for new businesses. Considering that some of the debt financing sources available to entrepreneurs can bear higher-than-average interest rates, digging yourself out from underneath this financial burden is no easy task. Also, delaying outside investments allows your business to grow not only in revenue and profit, but also in market value. When potential investors come along, they will consider a higher contribution for a smaller percentage in the business.

LINK TO LEARNING

One of the most common forms of debt financing is simply a credit card. Although it may seem wise to charge many of the upfront expenses and simply pay the card's minimum monthly payment, this can be a treacherous road to go down. Try the credit card calculator (https://openstax.org/l/52CreditCalc) to calculate how long it takes to pay off a credit using only the minimum payment. It may shock you. Try a few different amounts: $1,000; $5,000; and $10,000.

9.3 Accounting Basics for Entrepreneurs

Learning Objectives

By the end of this section, you will be able to:

- Explain the accounting equation and define its parts (assets, liabilities, and equity)
- Define revenue, expenses, and income

Although financing and accounting complement and rely on each other, they are distinct. As we have seen, financing is the process of raising money. **Accounting** is the system of recording and classifying financial transactions related to a business, and summarizing and communicating those transactions in the form of financial statements. Accounting is essentially documenting what happens to money once a company receives it and thereby makes that information available for reporting to stakeholders and regulatory agencies, and informing business decisions.

At the most fundamental level, an accounting system accomplishes two goals:

1. It summarizes a business's financial performance
2. It communicates that performance to owners, managers, and outside parties

The most common approach to accounting used in the United States, and around the world, follows the basic formula shown in Figure 9.6.

Assets = **Liabilities** + **Equity**

Figure 9.6 The accounting equation provides the foundation of a company's financial status and outlook. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

This formula is referred to as the basic **accounting equation**. First, we'll define each of these terms, and then we'll look at an example of a simple transaction recorded using the equation.

Assets are items—such as equipment, cash, supplies, inventory, receivables, buildings, and vehicles—that a business owns and derives future use from. Potential investors want to know what resources a company has at its disposal. Business owners want to see where their money has gone. Let's return to the case of Shanti, the website designer who starts her business by purchasing a new laptop computer. The computer is an asset that Shanti has acquired for her business.

A **liability** is a debt that a company has incurred with another party, as when it borrows money from a bank or purchases materials from other suppliers. The business is required to make a future payment to satisfy that debt. For accounting purposes, we want to be able to see what the business owns (assets) compared with what it owes (liabilities). For example, if Shanti does not have sufficient cash to pay for the laptop, she may have the electronics store charge her credit card for the purchase. In that case, the credit card company pays the store, and Shanti's business now owes the credit card company for the amount of purchase (a liability).

Equity is the owner's claim on the assets of the business, that is, the difference between what they own and what they owe. Essentially, equity tells a business owner or investor how much the firm is worth after all the debt is repaid. Returning to the example of Shanti's website design business, let's compare two scenarios of startup purchases to see the effects on the accounting equation. In both cases, Shanti contributes some of her own money to the initial purchase of a laptop.

In the first scenario, shown in Figure 9.7, she contributes $1,000 to the new business.

Assets	=	Liabilities	+	Equity
Cash				Owner's Capital
+1,000		0		+1,000

Figure 9.7 An initial $1,000 contribution by the owner is recorded in the accounting equation. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Each element of the accounting equation has its own account in an accounting system or software package, and all changes are tracked within its account. The accounting equation must stay in balance after every transaction with assets equaling liabilities. In this case, Cash is an assets account, and Owner's Capital is an equity account. The $1,000 cash contributed is a cash asset and becomes equity that is recorded as owner's capital. At this point, Shanti can claim 100 percent of the assets of the business, which right now consist only of the cash.

If she uses all of her cash assets to purchase the laptop, the accounting equation will record this as shown in Figure 9.8.

Assets		=	Liabilities	+	Equity
Cash	Computer				Owner's Capital
+1,000			0		+1,000
−1,000	+1,000				
0	1,000		0		1,000

Figure 9.8 The purchase of a laptop computer using existing cash is recorded in the accounting equation. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

When the cash is spent, reducing the assets column to zero, a new asset account for the computer is created to record the dollar amount paid for the laptop. Again, because Shanti doesn't owe another party at the end of the transaction (because she didn't make any additional contribution), the balance of the owner's equity account remains the same. The equation shows that Shanti still owns 100 percent of the assets.

Now consider how to account for a situation in which Shanti does not have a significant amount of cash to contribute to the business. She can afford to contribute only $100 and deposits the money into the business's bank account. Fortunately, she also has access to a credit card that can be charged for business purchases, increasing her investment options.

The initial contribution to the business is recorded in the same way but with the new amount, as shown in Figure 9.9.

Assets	=	Liabilities	+	Equity
Cash				Owner's Capital
+100		0		100

Figure 9.9 An owner contribution of $100 is recorded in the accounting equation. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

The laptop still costs $1,000, but the business has only $100 in cash assets. Shanti purchases the laptop with a credit card, and the clerk finalizes the sale. Figure 9.10 shows the impact of the sale on the accounting equation.

Assets		=	Liabilities	+	Equity
Cash	Computer		Credit Card		Owner's Capital
+100	0		0		+100
−100	+1,000		+900		0
0	1,000		900		100

Figure 9.10 The purchase of the computer asset using cash and a credit card is recorded in the accounting equation. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

In both examples, Shanti reports the computer as an asset of the business that is valued at its $1,000 cost. In the first scenario, she exchanged the cash for the computer. In the second, she exchanged a smaller amount of cash for the laptop and charged the remaining amount of the purchase on a credit card. This creates a liability for the business that Shanti will need to repay in the future. Since this is an equation, both sides must be equal to each other, and this proves to be the case in both scenarios. The total assets are $1,000, and the total liabilities plus equity are also $1,000.

ARE YOU READY?

The Accounting Equation

On a sheet of paper, use three columns to create your own accounting equation for your personal assets, liabilities, and expenses. In the first column, list all of the things you own (assets). In the second column, list any amounts owed (liabilities). In the third column, using the accounting equation, calculate the net amount of the asset (equity). When finished, total the columns to determine your net worth.

Here is something else to consider: is it possible to have negative equity? It sure is . . . ask any college student who has taken out loans. At first glance there is no asset directly associated with the amount of the loan. But is that, in fact, the case? You might ask yourself why make an investment in a college education—what is the benefit (asset) to going to college? The answer lies in the difference in lifetime earnings with a college degree versus without a college degree. This is influenced by many things, including the supply and demand of jobs and employees, and the field in which you plan to work.

9.4 Developing Startup Financial Statements and Projections

Learning Objectives

By the end of this section, you will be able to:

- Understand the three primary financial statements: balance sheet, income statement, and statement of cash flows
- Understand how financial projections are made and how to use the run rate and the burn rate
- Understand how to create a break-even analysis

You have learned how an accounting system classifies transactions in terms of assets, liabilities, and equity; what those transactions mean in terms of the accounting equation; and what that information says about an entity's overall financial health. Now we'll examine how to summarize those transactions in financial statements that can be shared with stakeholders. Internally, these statements are used to make decisions about the management of the company and its operations. Externally, they provide existing and potential investors with data to inform their financial support of the venture.

The information entered into the accounting system is summarized in **financial statements**, which are the output of an accounting system. We will examine three basic types of financial statements:

- The balance sheet
- The income statement
- The statement of cash flows

Each type of statement communicates specific information to its audience. Investors around the world use financial statements every day to make investment decisions.

LINK TO LEARNING

If you like quizzes, crossword puzzles, fill-in-the-blanks, matching exercises, or word scrambles, go to My Accounting Course (https://openstax.org/l/52MyAcctCourse) for some fun ways to reinforce the accounting information you are learning. This website covers a variety of accounting topics including financial accounting basics and financial statements.

The Balance Sheet

The first financial statement is the balance sheet. The **balance sheet** summarizes the accounting equation and organizes the different individual accounts into logical groupings. As you previously learned, the components of the accounting equation are:

- assets—items the company owns or will benefit from; examples include cash, inventory, and equipment
- liabilities—debt or amounts the company must repay in the future; examples include credit card balances, loans payable, and so on
- equity—the share of the assets due to the owners after debt is repaid

The accounting equation itself (assets = liabilities + equity) is spelled out on the balance sheet. It is shown in two portions. On one side, all of the assets are spelled out and their amounts totaled. This total is compared to the totals in the second and third portions, which show liabilities and equity. Just as the accounting equation itself must balance, so must the balance sheet.

Figure 9.11 shows the 2020 balance sheet for Hometown Pizzeria. This is the same kind of financial statement that real-life investors use to learn about a business. You can see the main aspects of the accounting equation in each half of the statement, as well as many detailed individual accounts. This financial statement gives the reader a quick summary of what the company owns and what it owes. A potential investor will be interested in both items. The amount of liabilities is an indicator of how much the business needs to pay off before the investors will see a return on their investment.

Unlike the accounting equation shown in Accounting Basics for Entrepreneurs, most balance sheets display data vertically rather than horizontally. But the vertical format still presents the two sides of the equation—except that liabilities and equity are on the bottom half of the statement. Note that the two sides still must equal each other, or balance—hence the name "balance sheet."

HOMETOWN PIZZERIA Balance Sheet For the Year Ended December 31, 2020	
Assets	
Cash	3,918
Ingredient supplies	1,720
Furniture and fixtures	5,654
Restaurant equipment	15,890
Total assets	27,182
Liabilities	
Accounts payable	1,890
Credit card payable	3,759
Total liabilities	5,649
Equity	
Owner's capital	21,533
Total liabilities and equity	27,182

Figure 9.11 This is Hometown Pizzeria's balance sheet. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

A review of the Hometown Pizzeria balance sheet lets us see what kind of assets the company has. We see cash, ingredients, and restaurant equipment—all things that would be necessary to make pizzas and sell them. We also see some liabilities. **Accounts payable** is an account that covers many different vendors that the company buys from on credit, which means the vendors let the pizzeria pay them after they have delivered their goods. These vendors could be companies that sell flour, produce, or pizza boxes. "Credit card payable" is the balance due on the credit card, which could have also been used to stock up on supplies or pay other bills.

One of the first things an investor will do is compare the total assets of a company with the total liabilities. In this case, the pizzeria reports total assets of $27,182 and total liabilities of $5,649. This means that the pizzeria owns more than it owes, which is a good sign. It actually has several times more assets than liabilities. Although it does not have enough cash to pay off all the liabilities right now, other assets have value and could be sold to generate cash.

To recap, the balance sheet summarizes the accounting equation. It tells the business owner what the company has and how it was paid for. Investors also want to understand where the company has spent its money and where that money came from. If a company is laden with debt, any investment may be immediately spent trying to get caught up with creditors, with no real impact on helping operations. Ultimately, investors want to read these financial statements to know how their money will be used.

The Income Statement

The second basic financial statement is the income statement, which provides the results of a company's operations. At the most basic level, the **income statement**—also called the **profit-and-loss statement**—describes how much money the company earned while operating the business and what costs it incurred while generating those revenues. An investor wants to know how much money the company brought in from customers and how much it had to spend to get those customers. Revenue minus expenses results in **net income**, or profit if there are funds left over.

After identifying total revenue and expenses, a business can calculate its profit margin. The **profit margin** is the profit divided into the total revenue, described as a percent. For example, if we opened a pizzeria and generated $100,000 in sales our first year and incurred $90,000 in expenses, that would result in $10,000 of net income. If we divide that net income by our $100,000 in sales, the profit margin is 10 percent. So for every dollar of sales that was generated, ten cents remained as a profit. We could save this resulting profit for future renovations, an expansion, or payment to the owners as a distribution.

A pizzeria—or any business that sells a physical product—has costs that are specific to the product sold. For example, pizza requires flour and yeast to make the dough, tomato sauce, and cheese and other toppings. We refer to these expenses as the **cost of goods sold**. These costs are the primary driver that determines whether the company can be profitable. If the selling price of a pizza is $12 and our cost of ingredients is $12, the transaction nets to zero. The company wouldn't make any money on a sale and is simply recouping the money paid for the ingredients. This is not a feasible business model because there are many costs in addition to ingredients, such as rent on the building, employee wages, and other items.

The selling price of an item minus its direct costs—or cost of goods sold—is the **gross profit**. In a product business, this is the most important operational figure. A business needs to know how much money it makes on each sale because that gross profit pays for all other expenses. If the pizzeria sells a pizza for $12, the cost of its ingredients might be $4, so the gross profit of selling one pizza is $8. Every time the company sells another pizza, the gross profit increases. If the business sells 1,000 pizzas in a month, its sales would be $12,000, the cost of goods sold would be $4,000, and $8,000 would be left for profit (Figure 9.12).

HOMETOWN PIZZERIA Income Statement For the Year Ended December, 2020	
Revenue	
Food and beverage sales	32,593
Expenses	
Cost of goods sold	9,777
Paper products	1,201
Rent	3,000
Salaries and wages	4,809
Utilities	2,753
Total expenses	21,540
Net income	11,053

Figure 9.12 This is Hometown Pizzeria's income statement. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Results from Operations

As you learned earlier in this chapter, a business can create assets through debt or equity financing. After the initial investment, those assets can be employed to operate the business. For example, when Hometown Pizzeria opens, after the initial build out of the kitchen and dining area, the business can make and serve food to customers in exchange for money. This process creates new assets in the form of cash collected from customers and becomes a third way to generate assets in a business—from operations, which we call revenue. In an ideal situation, the business would require little outside investment once operations have begun.

The amount a business earns from selling a product or providing a service is referred to as **revenue**, or sales. The costs incurred in the normal course of operations are referred to as **expenses**. For the newly opened pizzeria, payments from customers for their meals are the business revenue, whereas the cost of food ingredients, beverages, dinnerware, and paper goods—such as napkins—are the operating expenses. The balance of business revenue minus operating expenses is the profit of the business, or net income.

Before moving on to visualizing operational income, let's pause here to review some of the basic distinctions between these key terms. When a company gains new assets, those assets have to come from somewhere, usually from one of three sources. We will see these options on the right side of the equation, as we move from left to right. First, if we gain a new asset, but we have not paid for it, we have created a liability—something the business owes. This was the case when Shanti paid for her computer with a credit card. In the future, she will have to pay the credit card company, but this is different process from an expense, as we will see later. For right now, we are gaining something new and must repay someone later.

The second source of new assets is owner investments. This was the first example we saw when Shanti deposited money in the business's bank account from her personal savings. In terms of the business, assets increased because she now had more cash than before, and on the right side of the accounting equation, we record the source of those assets—Shanti herself. So investments by the owner are another source of new assets.

The third way that the business gains new assets is from operations. When Shanti uses the assets of her business (a computer) to perform work for a customer (creating a website), this results in a sale, or revenue.

Assets of the business increase because the customer pays for the work; thus, Shanti's cash increases. Again, on the right side of the equation, we record the source of that asset: revenue. Revenue is an increase in assets from customers paying for goods and services.

To illustrate, let's continue with Shanti's website design business. She purchased a computer with her personal savings and has been hired to create a website for a local business. This client agrees to pay $5,000 for the website, due on completion of the site. Once the work on the website is complete, Shanti records the receipt of $5,000 cash as an increase to the cash account. On the right side of the equation, this is added in an account under equity for revenue (Figure 9.13).

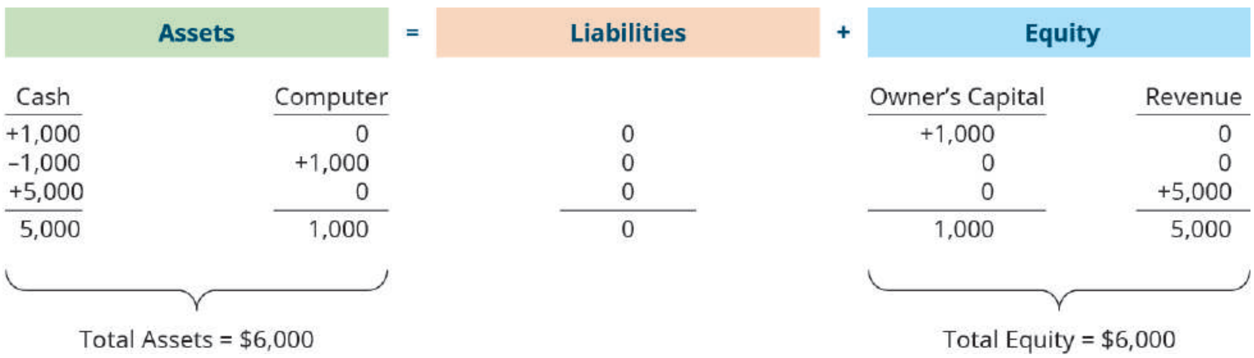


Figure 9.13 This shows recording a customer sale of $5,000. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

The total company assets have grown to $6,000 with the addition of the $5,000 earned and collected from this client. On the right side of the equation, equity has increased in a new column representing revenue and expenses, where revenues are positive amounts and expenses are negative amounts.

The accounting equation describes how transactions are classified within the context of balancing what a business has (assets) with how it paid for those assets (liabilities and equity). In the next section of this chapter, we will explore how this information is summarized in financial statements and how entrepreneurs and potential investors use that information.

LINK TO LEARNING

Accounting is the system of communication that allows for decision making by individuals both inside and outside the company. For an overview (https://openstax.org/l/52Accounting) of accounting, please see the video at the Investopedia website.

The Statement of Cash Flows

The third basic financial statement we will discuss is the **statement of cash flows**, which explains the sources of and uses of a company's cash.

You may wonder how the statement of cash flows differs from an income statement. The short answer is that the income statement captures events as they happen, not necessarily when the company gets paid. It records certain items, such as sales, when the work is completed. Let's return to Shanti, the website designer. As soon as she completes the client's website, the accounting system will record the *revenue*, the amount that is due from that client; this second item is referred to as **accounts receivable**. If Shanti's client is struggling financially or even goes out of business, she may never get paid for that work, but the income statement would show sales, and therefore possibly a profit. If the customer goes out of business, the business bank account will not have any evidence of a profit.

It is for this reason that the statement of cash flows was developed. It accounts for these differences, only showing activities that result in cash received or cash paid. To better understand the purpose and use of the statement of cash flows, let's first look at this statement again in the context of a pizzeria (Figure 9.14).

HOMETOWN PIZZERIA Statements of Cash Flows For the Year Ended December 31, 2020	
Cash Flows from Operating Activities	
Cash received from customers	50,000
Cash paid for ingredients and supplies	(18,000)
Cash paid for employees	(12,500)
Cash paid for interest	(3,300)
Cash paid for taxes	(3,900)
Net provided by operating activities	12,300
Cash Flows from Investing Activities	
Purchase of equipment and furniture	(55,000)
Cash Flows from Financing Activities	
Proceeds from long-term debt	60,000
Net increase (decrease) in cash	17,300

Figure 9.14 This is Hometown Pizzeria's statement of cash flows. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

As we can see in the statement of cash flows for Hometown Pizzeria, although the basic operations generate positive cash flow, a major purchase was required. This is common at the inception of a business. Not every location will come equipped with a commercial kitchen and dining area, so the business may need to purchase items such as a pizza oven and dining chairs and tables. Note that although the income statement approximates the cash flow from operations, it would not show the large outflow resulting from the initial purchase of equipment. That purchase would have been treated as an asset within the context of the accounting equation and would have been recorded on the balance sheet. So from that large difference alone, we can see why some people say that the statement of cash flows is the most important of the financial statements. It bridges the gap between the income statement and the balance sheet.

As you can see in the figure, the statement of cash flows is broken into three sections. The first is **operating activities**, the day-to-day activities of the business, including purchasing supplies, paying rent, and receiving cash from customers. This section tells a reader how effective the company's business model is at generating cash flow.

Investing activities include major purchases of equipment or facilities. For example, when Amazon develops its second headquarters, those billions of dollars spent will be recorded as investing activities. Additionally, if the company has an excess of cash, it may purchase securities such as stocks and bonds, which have a higher return on investment than a traditional bank savings account. This section tells a reader where the company spends money in terms of large acquisitions.

The third section of the statement of cash flows is **financing activities**. This section tells a reader where new infusions of cash come from. The owners of Hometown Pizzeria need to find a way to pay for the kitchen equipment and furniture. If they have such an amount in their personal savings, then they can simple contribute it to the company themselves. If they don't have the money already, they will need to seek other sources, such as loans or the types of investors discussed in Overview of Entrepreneurial Finance and Accounting Strategies. Generally, any financing activity is also booked in the balance sheet as well. This section of the statement explains which sources the owners used to generate outside funds coming into the business. It always indicates future requirements as well. For example, if a bank loaned the pizzeria the money, then we know it will have to be repaid in the future. So the business will need to ensure it is setting aside money to make monthly repayments. If new investors contribute money, what manner of return on investment will they be seeking? If they decide to seek regular distributions of profit, they will have to factor that in.

LINK TO LEARNING

It is a good idea to familiarize yourself with the type of information companies report each year. Peruse Best Buy's 2017 annual report (https://openstax.org/l/52BestBuy2017) to learn more about Best Buy. Take note of the company's balance sheet on page 53 of the report and the income statement on page 54. These reports have much more information than the financial statements you've seen, but as you read through them, you will notice some familiar items.

Projections

Among the most powerful tools business owners can use are projections. A **projection** is a forecast of the future operations of the business. It is a landscape for the business: What do the next few months look like? What about the next year? A projection would outline what level of payments are expected to come in and the timing of costs incurred. This lets the business owner understand what potential financing needs to be secured.

Two key concepts related to projections are the run rate and burn rate. The **run rate** helps extrapolate into the future. For example, if the pizzeria is generating sales of $10,000 per month, that translates into an annual run rate of $120,000 per year. Multiplying the monthly amount by twelve tells us the annual amount; if we wanted quarterly projections, we would multiply the monthly amount by three. This is useful for explaining to investors what the company will look like now that it has achieved traction in generating sales.

The **burn rate** is the rate at which cash outflow exceeds cash inflow, or essentially how much money the company is expending overall each month. Before generating revenue, or generating enough to just break even, startup companies will incur losses. Understanding the pace at which the expenses exceed revenue helps business owners plan accordingly. For example, if it takes six months to renovate the pizzeria and the monthly rent is $2,000, then the burn rate is $2,000 per month and forecasts that the business will need an additional $12,000 ($2,000 × six months) available in financing on top of the cost of renovations. The location's rent must be paid, even if the pizzeria isn't yet open for business.

During the seed stage of a company, projections can also be used to show potential investors how quickly the company will make money and hopefully inspire them to invest in the venture. Just as on *Shark Tank*, projections are used during the "pitch." Investors and lenders want to see exactly how they can expect the business to perform and how quickly the company generates positive financial results.

Break-Even Analysis

Another critical part of planning for new business owners is to understand the **breakeven point**, which is the level of operations that results in exactly enough revenue to cover costs. It yields neither a profit nor a loss. To calculate the break-even point, you must first understand the behavior of different types of costs: variable and fixed.

Variable costs fluctuate with the level of revenue. Returning to Hometown Pizzeria, we see that the cost of ingredients would be a variable cost. In a previous section, we also referred to these as the cost of goods sold. Variable costs are based on the number of pizzas sold, with the goal being to buy just enough ingredients that the business doesn't run out of supplies or incur spoilage. In this example, the cost of making a pizza is $4, so the total variable costs in any given month equal $4 times the number of pizzas made. This differs from a fixed cost such as rent, which remains the same every month regardless of whether the pizzeria sells any pizzas or not.

The first step in understanding the break-even point is to calculate the contribution margin of each item sold. The **contribution margin** is the gross profit from a single item sold. Therefore, selling price minus variable costs is the contribution margin. Hometown Pizzeria's selling price of a pizza is $12. The variable cost is $4, which results in a contribution margin of $8 per pizza. This $8 will go toward paying other expenses; when those are covered, the remainder will be added to the profit. Once we understand how much each item sold contributes to other expenses, we understand how those other costs behave (Figure 9.15).

HOMETOWN PIZZERIA	
Selling price of a pizza	$12
Cost of ingredients	(4)
Contribution margin	$ 8

Figure 9.15 This is Hometown Pizzeria's contribution margin. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

The other main category of costs is fixed costs. **Fixed costs** are a set amount and do not change, regardless of the amount of sales. Previously, we referred to rent as such a cost, but most of the business's other costs operate in this manner as well. Although some costs vary from month to month, costs are described as variable only if they will increase if the company sells even one more item. Costs such as insurance, wages, and office supplies are typically considered fixed costs.

Once variable and fixed costs are determined, this information can be used to produce a break-even analysis. Calculating the break-even point is simply a matter of dividing the total fixed costs by the contribution margin. To illustrate, let's assume that Hometown Pizzeria still sells pizzas with a contribution margin of $8 each. Let's also assume that the only fixed cost is the rent of $2,000 per month. If we wanted to know how many pizzas the owner needs to sell each month to pay the rent, we divide $2,000 by $8. This results in a break-even point of 250 pizzas. Now we know that if the pizzeria sells 250 pizzas a month, its rent is completely paid. Any additional pizzas sold add to the company's profit. If the business sells fewer than 250 pizzas, it will not generate enough income to cover the rent and will incur a loss. Whenever a business incurs a loss, the owners will need to contribute more of their own personal savings or potentially go into debt (Figure 9.16).

HOMETOWN PIZZERIA	
Total fixed costs	$2,000
Contribution margin of a pizza	÷8
Break-even point (in number of pizzas)	250

Figure 9.16 This is Hometown Pizzeria's break-even point. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Understanding the break-even point for a business provides a great deal of insight. At the most basic level, it demonstrates how many units of a product must be sold to cover the expenses of the business and not incur a loss. It may also help business owners understand when costs are too high and decide how many units need to be sold to break even. Realizing this up front can help entrepreneurs avoid starting a business that will result only in losses.

WORK IT OUT

Calculating Break-Even Analysis

Consider the break-even analysis tool. Using the same contribution margin provided ($8/pizza), calculate the break-even point if we chose a more expensive city. How many pizzas would we need to see if our fixed costs were $5,000 a month? What if they were $10,000 a month?

Key Terms

accounting system of recording and classifying a company's financial transactions and summarizing and communicating those transactions in the form of financial statements
accounting equation assets = liabilities + equity
accounts payable account that includes vendors that the company owes money to
accounts receivable account that includes customers that owe the business money
angel investor wealthy, private individual seeking investment options with a greater potential return than is generally available with traditional publicly traded stocks
assets items a business owns and derives future use from
balance sheet financial statement that summarizes a company's financial condition according to the accounting equation
bartering exchanging goods or services for other goods or services instead of for cash
bootstrapping funding strategy that seeks to optimize use of personal funds and other creative strategies (such as bartering) to minimize cash outflows
breakeven point level of operations that results in exactly enough revenue to cover costs
burn rate rate at which cash outflow exceeds cash inflow
charitable organization nonprofit company founded for altruistic purposes
collateral something of value pledged to secure a loan
contribution margin gross profit from a single item sold
cost of goods sold cost required to produce the product or service
credit lending of funds in exchange for a promise to repay
crowdfunding financing with investments of small amounts of money from a large number of people
debt financing borrowing funds that must be repaid, usually with interest
donation financial gift intended to support an organization's general operations
early stage company lifecycle stage in which the product or service has begun development
equity owner's interest in the assets of the business
equity financing funds provided in exchange for a share of ownership in a business
expenses costs incurred in the normal course of business operations
financial statement output of an accounting system that is used to make financial decisions
financial viability long-term financial sustainability of an organization to fulfill its mission
financing raising money to fund the startup and operation of a business
financing activities section of the statement of cash flows that shows where new infusions of cash are coming from
fixed assets major purchases with a long life, such as buildings, land, and so on
fixed costs costs that do not change, regardless of the amount of sales
funds financial resources for acquiring assets
grant financial gift intended to fund a specific goal or project
gross profit selling price of a product or service minus its direct costs
income (profit-and-loss) statement financial statement that describes how much a company earned while the business was operating and what costs were incurred to generate those revenues
initial public offering (IPO) process by which a company lists its ownership shares on a public stock exchange
investing activities section of the statement of cash flows that shows major purchases of equipment or facilities

liability company’s debt to another party
mature stage company lifecycle stage in which the business has reached commercial viability
moonlighting earning income from a source outside of one’s primary employ
net income revenue minus expenses
operating activities section of the statement of cash flows that shows day-to-day activities of the business, such as purchasing supplies, paying rent, and receiving cash from customers
profit margin amount by which revenue exceeds costs, typically described as a percent
program services basic offerings that a nonprofit provides to generate a portion of its revenue to sustain operations
projection forecast of the future operations of a business
revenue amount a business earns through product sales or providing a service
run rate cost of running a business over a specified period of time
seed stage company lifecycle stage in which the business is largely still an idea
statement of cash flows financial statement that explains the sources and uses of the company’s cash
sustainable strategy strategy that can maintain an organization’s financial stability
tax-exempt status treatment under U.S. tax law that removes the burden of taxes from nonprofit organizations
valuation estimate of a company’s worth
variable costs costs that fluctuate with the level of revenue
venture capitalist individual or investment firm that specializes in funding startup companies
working capital funds available for day-to-day operations

Summary

9.1 Overview of Entrepreneurial Finance and Accounting Strategies

Entrepreneurial financing is concerned with understanding the funding requirements for a new business and what sources of funds are available. Each source comes with different expectations and requirements. Equity financing provides the entrepreneur with maximum flexibility: Dividends are not required and can be made when cash flow is strong enough to meet all obligations of the firm. Debt financing restricts financial flexibility but can be cheaper under some circumstances. For example, SBA loans can be subsidized by the federal government. Financing is not a one-size-fits-all procedure.

9.2 Special Funding Strategies

For nonprofit organizations, achieving a sustainable funding strategy requires hard work, creativity, and a delicate balance of financial resources. These types of organizations need to create programs that will interest patrons who are willing to pay for activities. They also rely on the generosity of their benefactors beyond simple patronage in the form of donations, and they vie for extremely competitive grant funding.

Although loans and liabilities such as credit card debt can fund a new business, the repayment and additional interest charges are a real challenge to many entrepreneurs. Financing strategies that avoid loans, such as crowdfunding websites and bartering, offer opportunities for funding that are often more manageable.

Bootstrapping is the process of self-funding a startup business. Sometimes entrepreneurs will have no financial resources beyond their personal savings. This method of funding a business requires creative approaches to problem solving, generating business, and managing expenses. It can be a slower, more difficult process than a company with more funding might face, but in the long run, it can benefit the company’s strength and growth, and provide robust dividends to the founders.

9.3 Accounting Basics for Entrepreneurs

Accounting is concerned with how transactions are recorded in a way that helps entrepreneurs share information with stakeholders, including potential investors, and helps business owners make decisions about running their company.

9.4 Developing Startup Financial Statements and Projections

Entrepreneurs can use financial information for multiple purposes. These projections can help plan a new business. By forecasting the income and expenses of the first year, an entrepreneur can have a reasonable idea of the level of financing that may be required. Second, these projections can also show potential investors what the business will look like in the future and how long it might take them to get a return on their investment. Break-even points help illustrate a minimum amount of sales to cover expenses.

Review Questions

1. What are the different stages in a company's lifecycle?

2. How do financing requirements change at different stages of a company's lifecycle?

3. What are the two most common categories of financing available to an entrepreneur?

4. What is the Small Business Administration?

5. What is an SBA loan?

6. What is a charitable organization?

7. What is a sustainable funding strategy?

8. What is social entrepreneurship?

9. What is crowdfunding?

10. What is bartering?

11. What does the term *bootstrapping* mean in terms of startups?

12. What purpose does an accounting system serve?

13. What key terms are used in the accounting equation?

14. How does accounting differ from finance?

15. What are the basic financial statements? What information do they provide?

16. What are projections used for?

17. What is a break-even point?

Discussion Questions

1. How do funding requirements differ in each stage of a company's lifecycle? Why?

2. What are the advantages and disadvantages of different sources of financing?

3. How does collateral factor into your financing options?

4. What challenges do nonprofits face in securing financing?

5. What are some potential benefits of a crowdfunding campaign aside from the funding itself? What are some potential drawbacks?

6. What are some of the sacrifices you could see yourself having to make to bootstrap your potential business?

7. How would you work around having limited access to capital in starting your own business? What difficulties can you see in trying to do so?

8. Which external parties would be interested in obtaining a firm's financial statements?

9. Why would investors require access to financial statements?

10. How do companies use financial statements in communicating with potential investors?

11. How can an entrepreneur use preliminary financial information in planning a new business?

Case Questions

1. Crowdfunding platforms, such as Kickstarter or GoFundMe, allow startups to access many different investors who may be able to contribute only small amounts in return for relatively small rewards. In the case of the iBackPack, those providing funds through Kickstarter were largely unaware of the company's postfunding operations.

A. How did the lack of oversight harm investors?
B. How might this situation have been different if a single angel investor had been involved?

2. Put yourself in the shoes of the manager of a nonprofit organization, such as a homeless shelter. The ultimate goal is to help people who have suffered misfortune get back on their feet. They likely cannot afford to pay or otherwise contribute to the costs of running the shelter. Thus, you must look to other sources to help pay the bills. Visit the website https://blog.hubspot.com/marketing/engage-major-donors-foundations-list. What are some ways you might be able to attract donors for the shelter?

3. While thinking about or visiting the coffee shop in your area, look around (or visualize) and identify items or activities that are the expenses of the coffee shop. Remember, expenses for the coffee shop are related to resources consumed while generating revenue from selling coffee and related items. Do not forget about any expenses that might not be so obvious—as a general rule, every activity in a business has an associated cost.

Suggested Resources

9.1 Overview of Entrepreneurial Finance and Accounting Strategies

Small Business Administration lending program: https://www.sba.gov/funding-programs/loans

"The Top Twenty Venture Capitalists Worldwide," *New York Times* (March 27, 2017): https://www.nytimes.com/interactive/2017/03/27/technology/Top-20-Venture-Capitalists.html?_r=0

National Public Radio “How I Built This” podcast series (example episodes: Instagram, Airbnb, Spanx): https://www.npr.org/podcasts/510313/how-i-built-this

TED Radio Hour (example episodes: Big Data Revolution, Disruptive Leadership): https://www.npr.org/programs/ted-radio-hour/?showDate=2019-07-05

9.2 Special Funding Strategies

Tax information for charitable organizations from the Internal Revenue Service: https://www.irs.gov/charities-non-profits/charitable-organizations

Information from the National Institutes of Health on grants and the application process: https://grants.nih.gov/grants/about_grants.htm

Small Business Administration, “How to Start a Non-Profit”: https://www.sba.gov/blogs/how-start-non-profit

Kickstarter: www.kickstarter.com

Indiegogo, “The Essential Guide to Crowdfunding”: https://learn.indiegogo.com/the-essential-guide-to-crowdfunding

Startupfest, “The $100K Investment Prize”: http://www.startupfestival.com/news/100k-investment-prize/

G-Startup Worldwide’s global startup competition: https://www.f6s.com/g-startupworldwide/

Extending Credit to Your Customers: https://fitsmallbusiness.com/invoicing-extending-credit-to-customers/

7 Ways to Bootstrap Your Business to Success: https://www.entrepreneur.com/article/254217

4 Must-Follow Tips for Moonlighting as an Entrepreneur: https://www.entrepreneur.com/article/298310

5 Ways Nonprofits Can Engage Donors: https://www.ama.org/publications/MarketingNews/Pages/5-ways-nonprofits-engage-donors.aspx

9.3 Accounting Basics for Entrepreneurs

Small Business Administration Introduction to Accounting Course: https://www.sba.gov/tools/learning-center-view-course/364071

Accounting Coach free Accounting Basics Explanation: https://www.accountingcoach.com/accounting-basics/explanation

Khan Academy Accounting and Financial Statements Course: https://www.khanacademy.org/economics-finance-domain/core-finance/accounting-and-financial-stateme

9.4 Developing Startup Financial Statements and Projections

U.S. Small Business Administration: https://www.sba.gov/blogs/3-essential-financial-statements-your-small-business

U.S. Securities and Exchange Commission: https://www.sec.gov/reportspubs/investor-publications/investorpubsbegfinstmtguidehtm.html

Forbes, 5 Financial Reports You Should Be Running: https://www.forbes.com/sites/sageworks/2018/03/26/here-are-5-financial-reports-you-should-be-running/#183ae98d6548

Medium, 3 Phases of Financial Indicators for Startups: https://medium.com/@DanielleMorrill/3-phases-of-financial-indicators-in-startups-b18ddb97f5f0

10 Launch for Growth to Success

Figure 10.1 Dropbox, founded by Drew Houston and Arash Ferdowsi, has realized unprecedented growth, as the company is valued in the billions of dollars. (credit: modification of “Dropbox” by Ian Lamont/Flickr, CC BY 2.0)

Chapter Outline

Introduction

Dropbox, a company founded in 2007 by Drew Houston and Arash Ferdowsi, has revolutionized the way consumers and businesses store and share electronic files. The idea came one day when Houston—on a commuter train—realized he left his thumb drive at home. This was not the first time he had forgotten that tiny electronic filing cabinet, and he was sure others forgot often as well. So he hit on an idea: storing his files on a “cloud” on the Internet that anyone could access from anywhere with any device.[1] He wanted to manage file storage at faster speeds and in larger quantities than the few existing online storage systems, through an easy-to-use interface. Although Houston came up with the idea of cloud *storage* during his commute, cloud *computing* had been talked about in industry circles a few years prior.[2]

Hopeful, he introduced his idea to Y Combinator, a venture capital firm in California that helps fund startups by hosting, training, and helping them define their pitches to investors. Even though they had rejected a business

1 Sarah Buhr and Katie Roof. “A Brief History of Dropbox.” *TechCrunch*. March 6, 2018. https://techcrunch.com/gallery/a-brief-history-of-dropbox/slide/1/
2 Johnson Hur. “History of Online Storage.” *BeBusinessEd.com*. n.d. https://bebusinessed.com/history/history-of-online-storage/

idea he'd presented earlier, they told him the new idea was promising and asked him to secure a co-founder before pitching. A co-founder would help to secure funding because it showed the idea had legitimacy, support, and the expertise of another person. Houston quickly found Ferdowsi, a fellow MIT student studying engineering and computer science.[3] Together, they raised $1.2 million from investors, even though their prototype wasn't fully functional. They then hired developers and engineers who created a more functional version that worked across most computer operating systems.

Dropbox was soon using *lean startup* principles, which meant releasing an early version to early adopters. Houston had a difficult time explaining the product to initial users, so he developed a video with a quirky narration to entice them. The early product release was a hit: In one day, their customer base increased from 5,000 to 75,000 users, who could also provide them with feedback for subsequent versions.

Thanks to its massive success, Dropbox was valued at $10 billion in 2014.[4] However, some analysts believed the number was inflated as Dropbox's competitors started gaining market share. The company continues to receive customer feedback to make the iterations necessary for better versions.

10.1 Launching the Imperfect Business: Lean Startup

Learning Objectives

By the end of this section, you will be able to:

- Describe how businesses use lean startup principles to develop products and test markets
- Identify how the *build-measure-learn* method helps companies understand what potential customers want in a product
- Determine what a minimum viable product (MVP) is and explain why companies don't need to have a perfect product to launch
- Explain why companies need to learn to construct a lean pitch to investors and potential customers
- Explain what pivoting is and when it is necessary for companies to undertake

As you can see from the Dropbox example, businesses can function without being perfect. The company initially provided a short video description of the Dropbox product (https://openstax.org/l/52Dropbox) without even having it coded to the actual program first.[5] This way, they could test the idea and receive customer feedback without losing time or money on products that wouldn't work. If any changes were needed, they had the flexibility to make them because it was just an early prototype and no big investment on the product had been made yet. Many of the early changes were to the interface design that involved buttons and actions that could be taken, and storage capabilities that customers consistently gave feedback on.

New businesses need time to develop their identities, engage their target market, create and develop the right products, and sharpen their strategies. Startups don't have fully developed and proven business models like established companies do. A business's starting focus or idea may evolve into something else because the initial feedback from the prototype points in a different direction.

Houston (pictured in Figure 10.2) and Ferdowsi knew they did not have the perfect product, so they employed a system called **lean startup**, a methodology entrepreneurs use to help them innovate by continuously testing their products and getting feedback from customers in real time. This methodology calls for a product to be

3 "How I Met My Co-Founder: Drew Houston, Dropbox." From *Finding Your Way as an Entrepreneur*. May 30, 2012. https://ecorner.stanford.edu/in-brief/how-i-met-my-co-founder/

4 Eliot Brown and Jay Greene. "Dropbox Files for IPO Three Years after $10 Billion Private Valuation." *The Wall Street Journal*. January 11, 2018. https://www.wsj.com/articles/dropbox-files-for-ipo-three-years-after-10-billion-private-valuation-1515708036

5 "The Original Dropbox MVP Explainer Video." *Allen Cheng*. n.d. https://www.allencheng.com/dropbox-mvp-explainer-video/

shared with early adopters in its beginning stages of development and gain immediate feedback. It ensures that people actually like a product and are willing to buy it. Tech companies primarily use this method because they have learned that too many years working on a product without measuring is highly risky, especially in a rapidly changing technological environment. Lean strategy, though, is applicable to almost every business and industry.

Even with Dropbox's reported $1 billion in revenue and 500-plus million users, Houston's journey still has its ups and downs. He learned that the CEO's job changes as the venture progresses because the company's needs vary across its lifecycle. The CEO has to shift focus, such as on building prototypes, testing users, exploring the best distribution channels, and managing cash flow. These hurdles need to be tackled when they arise.[6] Let's take a closer look at lean startup, and how it got its own start.

Figure 10.2 Andrew Houston believes that, as a CEO, you must shift your focus as your business needs change. (credit: "Drew Houston (Dropbox) by Financial Times/Wikimedia Commons, CC BY 2.0)

Lean Startup

Author and entrepreneur Eric Ries developed the lean startup methodology after spending much time, effort, and money when his first tech company had to close down. Fortunately, Ries' frustration led him to study other successful companies and lean manufacturing programs, including the highly successful Toyota lean manufacturing process, which taught him how to be flexible and quick while building products. He learned that he didn't need to have a fully designed product resulting from years of development; instead, he could have something imperfect that worked without the bells and whistles, something that people could test and provide feedback on over time.

LINK TO LEARNING

Dr. Jeffrey Liker is an industrial operations management scholar, specializing in lean principles. Watch his presentation describing the basic components of lean manufacturing leadership (https://openstax.org/l/

6 Scott Rosenberg. "Inside Dropbox's Identity Overhaul." *Wired*. January 30, 2017. https://www.wired.com/2017/01/inside-dropboxs-identity-overhaul/

52LikerLean) to learn more. These components are the heart of Toyota's 14 management principles (https://openstax.org/l/52ToyotaWay) known as the Toyota Way.

He advocated a step-by-step approach on how to maneuver a startup, how to change course if necessary, persevere, and accelerate its expansion. This is also called the **build-measure-learn loop**, which means that a prototype is built, or at least the idea is written down, it is then pitched to customers who provide feedback so the company learns what to keep and what to change, then it makes the changes to the prototype, and starts all over again, repeating the process until the prototype is good enough to go to market. Figure 10.3 illustrates this loop. Even after it hits the mass market, this loop can continue to be used to enhance the product.

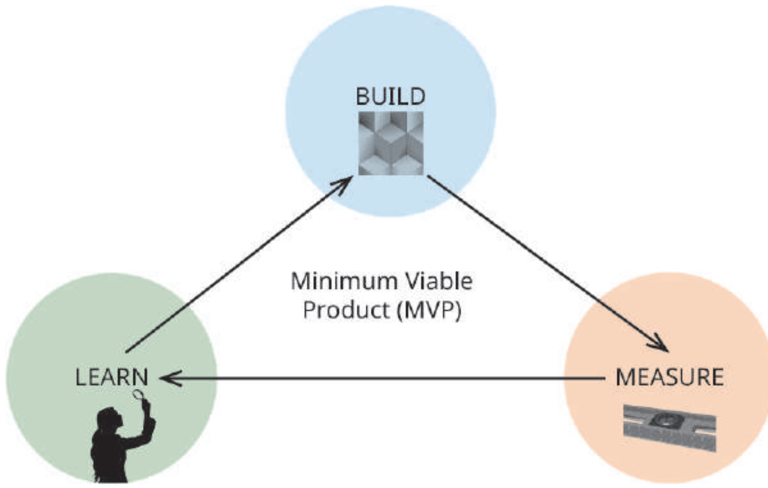


Figure 10.3 The build-measure-learn loop is a framework that helps entrepreneurs develop their idea into a minimum viable product (MVP), measure its impact on people, and learn if there is a need to pivot (change) or persevere. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

After his first startup proved unsuccessful, Ries created a second company called IMVU.[7] IMVU is an avatar platform, or "metaverse," for people who want to shop for clothing, furniture, and accessories in an online community and keep their identity safe. Essentially, IMVU is a virtual reality world with an e-commerce engine, user-generated content, and 3-D characters. While Ries was building IMVU, he and his co-founders worked endless hours for six months to create a prototype of 3-D avatars that they later learned no one wanted. During their first month, they made a total of $300. The next month they made $400 after begging friends and family to try it.

After Ries saw their faithful first customers disappear, he and his co-founders decided to shift from feeling frustrated to talking to potential customers. They tested their product with teenagers and heavy users of technology, as well as with mainstream customers. The mainstream customers never knew what to do with the product. They thought it was too strange. But those that were more tech savvy and younger were happy to try it. They gave a lot of feedback that resulted in creating a better version of the avatar community.[8]

The initial platform was designed as a **minimum viable product (MVP)**, which is a very early prototype of a product.[9] According to Ries, an MVP can be the bare minimum to help people understand what the product is about. A product doesn't even have to be built to be an MVP; instead, it can be represented in sketches, videos,

7 Eric Ries. *The Lean Startup* (New York: Crown Business, 2011), 1–8.
8 Eric Ries. *The Lean Startup* (New York: Crown Business, 2011), 43.
9 Eric Ries. *The Lean Startup* (New York: Crown Business, 2011), 43.

and explanations of how it might look. MVPs also can include a basic version of the product, just like IMVU's website, which was not very good at first. The point is to have a basic product to show to potential users, with enough substance to elicit feedback on what people find useful and what attributes are important without having to invest a lot of money and time. There is no right or wrong type of MVP. It is up to the owner to decide how to showcase the idea and test it to find out what people like and don't like, and how to take the idea to the next level.

Through this MVP experience, Ries (shown in Figure 10.4) realized that his first platform had bugs and issues that could crash users' computers; however, in spite of the bugs, he was determined to get customer feedback without spending lots of cash or time. Once he and his co-founders had the low-quality platform running, they decided to charge a fee for the service. They would send dozens of changes to their loyal followers until they developed a product that would work for a larger customer base. These changes included adjustments such as adding new avatars, new avatar movements, choices of clothing, and new worlds for avatars to explore. IMVU pioneered this lean startup approach, which new ventures all over the world now use. Today, IMVU is a successful enterprise with over $55 million in revenue and 50 million users.[10]

Figure 10.4 Eric Ries, third from left, speaks at a conference about the lean startup process he developed while creating his second business. (credit: modification of "Eric Ries TechCrunch Disrupt" by "kawanet"/Wikimedia Commons, CC BY 2.0)

A lean startup begins with the first stage of *building* a basic product (MVP) that has only its core benefits and no extra features. Houston and his developers created a basic platform for early adopters to test. **Early adopters** are people who like to try new products as soon as they come out. They don't mind, for example, buggy software or cumbersome designs because they are innovators and like to test new things. Dropbox did not create a perfect product initially because the developers did not know what it would be until they got user

10 IMVU Inc. "IMVU Inc. Celebrates Nine Years of Connecting People around the World, Expands Profitable Business to Mobile." *PR Newswire*. April 8, 2013. https://www.prnewswire.com/news-releases/imvu-inc-celebrates-nine-years-of-connecting-people-around-the-world-expands-profitable-business-to-mobile-201920201.html

feedback. After early signups and feedback on the first prototype, they were able to create the first version of the product. Later, they conducted **iterations**, or additions or changes to the version of the product, using customers' ideas and suggestions.

Zappos is another example of an MVP development project. Nick Swinmurn, creator of the online shoe company, launched the idea in 1998 by creating a bare bones website to sell shoes and measuring traffic to the site.[11] The idea started after he took a trip to the mall and could not find shoes in the styles or colors he wanted. He figured other people had equally frustrating experiences. His first hypothesis was that people were interested in buying shoes online, so he asked Tony Hsieh, current CEO of Zappos, to invest in this new project. Hsieh provided half a million dollars to get the company started. Swinmurn then created a plain webpage that started with basic photos of shoes and their prices. Swinmurn also ran ad campaigns, measured web traffic, and adjusted the webpage. Instead of spending so much time in building a detailed plan about his business, this method helped him make quick adjustments to the product, the target market, and strategies using the build-measure-learn loop and starting with an MVP, just as Houston did.[12]

WORK IT OUT

Five Lean Principles

Go to the website http://theleanstartup.com/#principles and click on the link "Lean Startup Process In Detail."

- Pick one topic that interests you and write a one-page summary of the concept.
- Add an example to illustrate the topic.

Going deeper into this *build* stage, we can see that the steps take an entrepreneur through a cycle or loop that begins with defining the problem at hand and building the MVP to show potential consumers a sample of the product and see how they react. In many cases, selling this low-quality product can also help measure user reactions. Metrics, or measurements, are developed to test the product assumptions of the engineers who created it. The goal is to test the MVP with its target market by asking questions about the design, usability, core or bundle of benefits, and other attributes that enhance the customer experience.

For example, different design attributes can be measured by asking customers if they like a feature or set of features of the product they are testing. The number of likes or dislikes can be tallied, and comments can be collected on what additional features should be added or deleted. Once the feedback comes in, entrepreneurs can make changes. Then, they can move into the next stage, which is to *measure* whether the changes to the product based on the feedback are actually helping make progress.

Along with a minimal product offering, Ries advocates using a minimal financial evaluation concept called **innovation accounting** to assess whether the changes made to the product are creating the desired results. This means that entrepreneurs should not look first to the basic financial measurements traditional to businesses—such as sales, profits, and return on investment—because these traditional measurements aren't the most relevant metrics at this stage. Instead, they should measure progress in a different way. Measurements may include testing assumptions about the business, attributes that customers like, sign-ups,

11 "Lean Startup Zappos: The Basics." *Bullet*. n.d. https://www.bullethq.com/lean-startup-zappos-how-zappos-validated-their-business-model-with-lean/

12 "The Lean Startup Methodology." *The Lean Startup*. n.d. http://theleanstartup.com/principles

and retention rates that can be separated into cohorts and tested, say weekly, as changes to the products are made.

LINK TO LEARNING

Read this article on innovation accounting (https://openstax.org/l/52InnovAccount) and notice the available metrics that measure progress and the instances in which they are effective.

During the *learn* stage, the entrepreneur uses the feedback obtained to assess the progress of the product in an objective manner. The entrepreneur makes changes to the MVP and starts the cycle over again until the process has reached a point where it either accelerates or needs to pivot.[13]

As a learning component for the company, feedback is very important in the lean process. Feedback helps companies design better products and make iterations, or newer versions, which better serve the customer base. Companies will work with early adopters for a while before they expand their reach with a better product and entice more people to use it.

ENTREPRENEUR IN ACTION

General Electric Is Big *and* Lean

General Electric (GE) is a company that has been around for many years and boasts a tremendous portfolio of businesses under its parent company. Eric Ries managed to encourage this giant to take advantage of the lean startup movement by collaborating with him in a new program called Fast Works. This program was essentially created to imbue its product development method with the principles of lean innovation by training thousands of employees in the methodology and helping them develop desirable products at a faster pace.

For example, GE improved a turbine using the lean approach by asking for customer feedback. Many customers needed different features, such as improved reliability, better fuel efficiency, and faster operation. The team working on this project decided to use Fast Works to fulfill all of the customers' requests. This approach would allow them to shorten the development process and save the customers money. Three hundred members of the GE turbine team knew that this would be a difficult task given their locations around the world and the processes involved in approvals, so they got to work. Some focused on streamlining the approval process, while some worked on bottlenecks and encouraged low-level engineers to make difficult decisions without asking upper management. These two changes allowed them to pivot quickly, while gathering feedback and making changes to the turbine effectively. After using FastWorks, the team reduced development time by a quarter—from four to three years. They saved $5 million dollars in fuel per year for their customers, while increasing their revenues by $6 million per year.[14]

13 Eric Ries. *The Lean Startup* (New York: Crown Business, 2011), 76–183.
14 Bruce Watson. "The Startup Power Plant: These Engineers Are Building Turbines the Silicon Valley Way." *General Electric*. May 3, 2017. https://www.ge.com/reports/startup-power-plant-adapting-silicon-valley-methods-building-turbines/

Iterating, Pitching, and Pivoting

Many companies invest significant time and effort on projects that seem like great ideas in theory but flop when taken to market. The lean startup method is a new way to develop and manage products that people want in a shorter period of time. Companies are able to learn from customer discovery and validation that the offer or value of the product is not working and needs to be enhanced or changed.

After Ries experienced his first business loss, he recognized the problem of companies devoting time and money on projects rejected by consumers, and he wanted to identify a solution. As he started his new company's avatar community, he enabled his teams to put the product through iterations—those small changes to the current version of a product to make it better fit consumer needs. At this phase, and using lessons from his first failure, he strove to create a bare-bones version of a product that worked well enough to provide core value to the customer, garner customer feedback, and make small adaptations around what users considered most essential. This allowed IMVU to enhance the product in a way that brought the company, step by step, closer to providing the best value.

One iteration that proved enormously successful was adjusting how the avatar moved through its virtual reality world. The original avatars didn't have the ability to walk around like they do in, say, popular multiplayer video games. Even though he knew this was a disadvantage, he sent the version to early adopters and asked for feedback. Customers responded that the lack of movement suggested the software was low quality. Reluctant to make the major tech investment for this movement, Ries and his team decided to try a very small iteration as an alternative: They made the avatar disappear from its starting point and reappear in its new location. Customers responded positively, seeing this as superior to what existed and as a high- quality variation. The quick and low-cost iteration turned out to be the best path to success.[15]

In addition, while this process is ongoing, the entrepreneur is constantly pitching the idea to potential consumers and investors. Pitching can be intimidating for entrepreneurs, as they can get nervous speaking in front of people. However, pitching can be as important as building the right product for the right target: It needs to be practiced and mastered.

Pitching is the verbal delivery of an idea or business plan, and a request to a group of investors, customers, or potential business partners by an entrepreneur (Telling Your Entrepreneurial Story and Pitching the Idea). As an entrepreneur, knowing how to pitch your business concept to investors is one of the keys to success. However, if you're using the learn startup approach, your pitch likely needs to be quite different from a regular pitch.

The **lean pitch** requires the presenter to craft an exciting and well-developed story about the company, its product, and what makes the product unique, with enough detail to show that the company is more than a story in the presenter's mind. The lean approach is customer centric and tries to solve customers' problems and resolve issues, and it measures its product over and over again until it is right. The story must show the process of understanding their customers as well as their problems and issues. Then, there must be an explanation of iterations, design tests, and learning from customer feedback that demonstrates the customer-centric approach. Experiments, data, and insights are shared to show the company's progress. As you recall from Telling Your Entrepreneurial Story and Pitching the Idea, using a regular pitch approach, the presenter gives all of the details of the product and the future launch. This traditional pitch asks for an investment without having tested assumptions or having much data or experiments to show that the idea will work.[16] Increasingly, successful lean pitching requires the presenters to have some sort of validation of their business

15 Eric Ries. *The Lean Startup* (New York: Crown Business, 2011), 108.

16 Andy Cars. "How to Pitch to Investors Using a Lean Startup Approach." *Medium*. March 15, 2017. https://medium.com/lean-startup-circle/how-to-pitch-to-investors-using-a-lean-startup-approach-852f7a503d84

model because this shows more truth to the vision. Many investors look for companies that have some time invested and a seed customer base under their belt. They are particularly interested in those who know their sales numbers, their costs, their sales projections, and have a track record of increased sales, customers, and profit. Table 10.1 shows a step-by-step approach to pitching to investors and potential partners.

Lean Startup Pitching

Step	Tips
1. Tell an exciting story that quickly moves into tangible results	Don't do a sales pitch; be yourself by being open and authentic. Craft an exciting and well-designed story to capture your audience and introduce this as a business that is already up and running so investors know from the beginning that you are using lean startup techniques.
2. Describe the problem and solution at hand and what makes you unique.	Clearly define the problem you are solving and how you are already solving the problem with the best tested/measured solution.
3. Describe the target market and how it will benefit from the product.	Show that you understand your potential customer because you have gotten customer feedback. Give examples of early product development and share key customer feedback that helped you enhance or incorporate new benefits. Demonstrate the product, focusing on the benefits, not the features.
4. State your position with facts and achieved results.	Show additional tests, experiments, customer feedback, and anything that can back your claims. Show actual data and insights collected, emphasizing validated facts and assumptions you have made. Describe early challenges and how you adapted without giving up.
5. Be simple	Don't use jargon. Speak as if you were explaining it to a stranger sitting next to you in a coffee shop.
6. Show current progress	Show what you have accomplished in sales/profit so far.
7. Finish with the ask	Close up your pitch by identifying what you are seeking. If you are looking for an investment, a partnership, a new member to join you, or an advisor, finish with the ask.

Table 10.1

After carefully going through the build-measure-learn loop, there comes a point where the company either accelerates or realizes it's time to pivot. **Pivoting** is a crucial and often difficult change done to test a hypothesis regarding the basic product, its growth potential, and business model. Once the product has been tested and retested for changes in consumer behavior, or any metric that the company sets itself to attain, if it's not attaining growth, then the next step is to pivot instead of continuing down the current path.

This is a time for tough decisions: Should you continue working on the business, product, or project—or should you change? Is the company making progress toward its goals, or do the strategies need major adjustments? While measurable data, such as attribute likes and dislikes, or number of sign ups, are gathered during the measure stage, the lean startup process also has a component that is creative, intuitive, and visionary. Knowing when to change cannot be determined solely through number crunching. It also requires human judgment, which, when coupled with the build-measure-learn formula, can lift a company out of mediocrity.

WORK IT OUT

Ten Ways to Pivot

Read this article from Forbes.com to see more examples of the kinds of pivots entrepreneurs can make: https://www.forbes.com/sites/martinzwilling/2011/09/16/top-10-ways-entrepreneurs-pivot-a-lean-startup/#3286d2422d2b.

- Which one(s) would be best for your current business project? Why?
- What product features would you have in place to ensure future growth without investing too much?

If a business is not growing, it is shrinking or stagnating.[17] A pivot, just like in basketball, requires one foot down on the ground, and the other moving. This means that you keep what you have learned from customers as your grounding foot but test out a different direction in which to move. Here are examples of famous pivots:

- Twitter transformed into a social media giant from a company called Odeo, a broadcast platform that was initially created to transmit video, sound, and podcasts. However, Apple beat them by launching iTunes podcasting, and it didn’t make sense for the founders of the company to pursue that path, so they decided to create Twitter instead.
- PayPal (formerly Confinity) allowed people to send electronic payments or “beam” payments from their Palm Pilots (first personal digital assistants created by Palm Computing) as well as from other devices. At that time, PayPal users registered a card number, downloaded the beam application, and were able to make transfer payments from one device to another. As technology changed, it merged with X.com to become the preferred payment method on Ebay, helping the company go mainstream.
- Avon was created by a traveling book salesman who would add perfumes to his sales as perks for his female customers. Eventually, he realized that women were more interested in the perfumes than the books, so he started a new business from a small office in New York.
- Fab.com, a design e-commerce website, was initially called Fabulis, and it started as a social media site to connect gay men. After the social media site failed, the co-founders took it into a new direction by selling their design picks for the best home goods, accessories, and clothing for everyone.[18]

17 Eric Ries, *The Lean Startup* (New York: Crown Business, 2011), 149–178
18 Jason Nazar. “14 Famous Business Pivots.” *Forbes*. October 8, 2013. https://www.forbes.com/sites/jasonnazar/2013/10/08/14-famous-business-pivots/

WORK IT OUT

The Market for Experiences

Since the 2009 recession, people have spent more on *experiences* like travel and dining, rather than goods. Instead of owning many products, people, especially Millennials and Gen Zers, are transforming many industries. They prefer to travel by Uber and have an Airbnb experience where places and people are more important than things. They would rather freelance than work for a corporation and are more likely to try new foods and entertainment instead of accumulating possessions. This market trend has led many large retailers to downsize or close all together. Smaller retailers have been hurt as well. However, online retailers, home stores, and grocery chains have remained largely immune to the changes in buying habits.

- If you were a specialty retailer that focused on selling sports clothing and gear, and had several regional stores around the country, how would you pivot your business to avoid slowing sales?
- Create a step-by-step list of your main strategies and how each would help avoid closing down your business.

You may wonder, how many times can a company pivot? Ries likes to use a runway analogy: You must measure how long you have until your company can achieve its goals, and whether you fail to lift (burn through all your cash resources) or have a liftoff (generate sales, sign ups, add new customers). The runway can be calculated by taking the amount of cash that is in the bank and dividing that by how much is being spent or drained on that balance. So if your company has $550,000 in the bank, and it drains or burns $50,000 per month, then you have a projected time of 11 months (550,000/50,000). A way to slow down the cash drain—and to extend the runway—is to cut some costs or ask investors for additional cash.[19]

There are also different types of pivots for different needs. Table 10.2 shows ten pivots an entrepreneur can make according to feedback.

Types of Pivots[20]

Pivot Strategy	Description
Zoom-in	A product’s single feature becomes a whole product.
Zoom-out	This is the reverse of zoom-in. A single feature is not enough for a customer, so the product needs added features.
Customer segment	There is a need to change the customer segment, as the one studied is not representative of who will buy the product at a larger scale.

Table 10.2 Eric Ries outlines these ten pivot strategies in *The Lean Startup*.

19 Eric Ries. *The Lean Startup* (New York: Crown Business, 2011), 160.
20 Eric Ries. *The Lean Startup* (New York: Crown Business, 2011).

Types of Pivots

Pivot Strategy	Description
Customer need	Feedback from customers shows that the problem solved is not important. The product needs to be repositioned, or a new product needs to be created to solve a real problem.
Platform	A change from an application to a platform or the other way around is needed. Startups usually begin with what is called a “killer app” for their platform, which later becomes a way for third parties to create their own products.
Business architecture	This is a change from high margin, low volume to low margin, high volume. This happens in business-to-business (B2B) and business-to-customer (B2C), respectively.
Value capture	These are changes in monetization or capturing value (raising capital).
Engine of growth	A startup changes its engine of growth (sticky, paid, or viral paid growth models for revenue). Usually, the company requires a change in the way it collects revenue.
Channel	Distribution channels are changed when the product requires faster or broader alternatives to reach consumers. The Internet has become a great disruptor of channels.
Technology	Sometimes achieving a solution that serves an existing customer through cheaper means occurs when other technology is used (new production equipment, new software, etc.). This is more common with established businesses.

Table 10.2 Eric Ries outlines these ten pivot strategies in *The Lean Startup*.

ENTREPRENEUR IN ACTION

Nintendo

Nintendo could have gone sour in the gaming world had it not made a fateful pivot at a stark time. Created in 1889 (surprising, right?) in Kyoto, Japan, Nintendo manufactured “hanafuda,” or flower cards (pictured in Figure 10.5) **(a)** used to play card games. It was humming along until the card game industry started to decline in the 1960s. Fusajiro Yamauchi, founder of Nintendo, tried to move into other markets by also providing hotel and taxi services. These pivots proved unsuccessful choices, and Nintendo almost closed its doors. However, it continued to manufacture its cards, which now had a plastic coating, and, thanks to a deal with Disney, had moved into the character cards market.

Still, the company hobbled along until, thankfully, one of the line assembly engineers created a device that would reboot sales. He designed a toy called the Ultra Hand, which children could manipulate to reach objects far and away. After successfully selling a million units, the company rebranded itself as Nintendo Games and entered the growing toy market.

Their foray into video games found its first success with the release of the Color TV Block Breaker game in 1977 (pictured in Figure 10.5 **(b)**). In 1981, when technology was changing the gaming industry, Nintendo created Donkey Kong, and later in the 1980s, Mario Brothers. Thanks to this great pivot, Nintendo is now worth over $22 billion and continues to thrive as one of the top gaming companies in the world.[21]

(a) **(b)**

Figure 10.5 Nintendo started as a small company that created (a) Hanafuda cards and (b) the Color TV Block Breaker. Today Nintendo is one of the largest companies in the gaming industry valued at over $22 billion. (credit (a): modification of “Koi-Koi Setup” by “Aldaron”/Wikimedia Commons, CC BY-SA 3.0; credit (b): modification of “Nintendo-Color-TV-Game-Blockbreaker-FL”by “Evan-Amos”/Wikimedia Commons, Public Domain)

10.2 Why Early Failure Can Lead to Success Later

Learning Objectives

By the end of this section, students will be able to:

- Determine several reasons for business failure and explore strategies to overcome them
- Understand the root of fear of failure
- Learn to spot signs of fear of failure and take steps to overcome it

Your goal in your venture is to achieve success—ideally, fairly quickly—but most successful entrepreneurs experience some failures along the way. While these setbacks can be discouraging, they provide lessons and experiences that can lead to eventual success. Whether a new business is a retail store, restaurant, hair salon, consulting company, tech firm, or manufacturing plant, the truth is that many businesses fail within the first couple of years. According to Bloomberg, only 20 percent of new businesses find success within their first eighteen months.[22] Data from entrepreneur.com and the Small Business Administration suggest that only 30 percent of new ventures succeed to the ten-year mark.[23],[24] For women and minorities, the percentages are

21 Mary McCoy. “5 Cases of Companies That Successfully Pivoted Business Models.” *Continuum*. July 21, 2015. https://www.continuum.net/blog/5-cases-of-companies-that-successfully-pivoted-business-models

22 Eric T. Wagner. “Five Reasons 8 out of 10 Businesses Fail.” *Forbes*. September 12, 2013. https://www.forbes.com/sites/ericwagner/2013/09/12/five-reasons-8-out-of-10-businesses-fail/#1c5fbca26978

23 Patrick Henry. “Why Some Startups Succeed (and Why Most Fail).” *Entrepreneur*. February 18, 2017. https://www.entrepreneur.com/article/288769

24 “Frequently Asked Questions.” *US Small Business Administration Office of Advocacy*. June 2016. https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2016_WEB.pdf

even lower. Success and longevity are possible, of course, but it takes a lot of work, and sometimes it takes a second or third try.

Entrepreneurs recognize that failure is part of the success of being a business owner. **Business failure** is the ending of a business due to the lack of goal attainment, which can mean low levels of revenue and profits, or not meeting investors' expectations. Business failure can result in the loss of assets—such as revenue, equipment, and capital—and can cause trauma for the business owner. However, these failures often help entrepreneurs improve the outcomes for their next business, as they have now learned valuable lessons that can be applied to new projects.

As Jack Ma, billionaire founder of Alibaba (the biggest and most profitable online retailer in China) said, "No matter what one does, regardless of failure or success, the experience is a form of success in itself."[25] Ma experienced many failures—including being rejected from job opportunities and universities he wanted to attend, and having his pitch rejected by all but one person in a room full of friends. But he persevered, founded Alibaba, learned as he went, and today runs China's largest online retailer with almost $24 billion in revenue.[26]

Another company, Quirky, launched by Ben Kaufman in 2009, was an initial failure. Quirky was a platform that allowed inventers to submit their ideas to a panel of Quirky experts who would then manufacture the product at a low price and sell it to different markets. Initially, Quirky gained $185 million in funding and had support partnerships from Amazon, Bed Bath & Beyond, and Best Buy. Thousands of people flocked to the site and submitted their inventions to get seen and voted on. Unfortunately, Quirky struggled to sell many of the products at a sustainable profit margin and filed for bankruptcy in 2015 after investors stopped funding the venture. Fortunately, one of its businesses, the smart-home business section, was spun off and sold as Wink in September 2017. The company was rebooted by a new set of entrepreneurs with a better business model.[27]

Common Contributors to Failure

There are some common reasons for failure that often combine to end a business. However, there are often ways to prevent these failures from happening. CB Insights, a company that mines and analyzes data for companies and uses machine learning to help them answer complicated strategic questions, researched the factors that contributed to the failures of 101 startups. Figure 10.6 shows some of the main factors they identified in their research.

25 Zach Ho. "Jack Ma: If You're Still Poor at 35, You Deserve It!" *Vulcan Post*. April 15, 2014. https://vulcanpost.com/7702/jack-ma-youre-still-poor-35-deserve/

26 Zach Ho. "Jack Ma: If You're Still Poor at 35, You Deserve It!" *Vulcan Post*. April 15, 2014. https://vulcanpost.com/7702/jack-ma-youre-still-poor-35-deserve/

27 Jessica Sylvester. "The Rise and Fall of Quirky: The Startup That Bet Big on the Genius of Regular Folks." *New York Magazine*. September 13, 2015. http://nymag.com/daily/intelligencer/2015/09/they-were-quirky.html

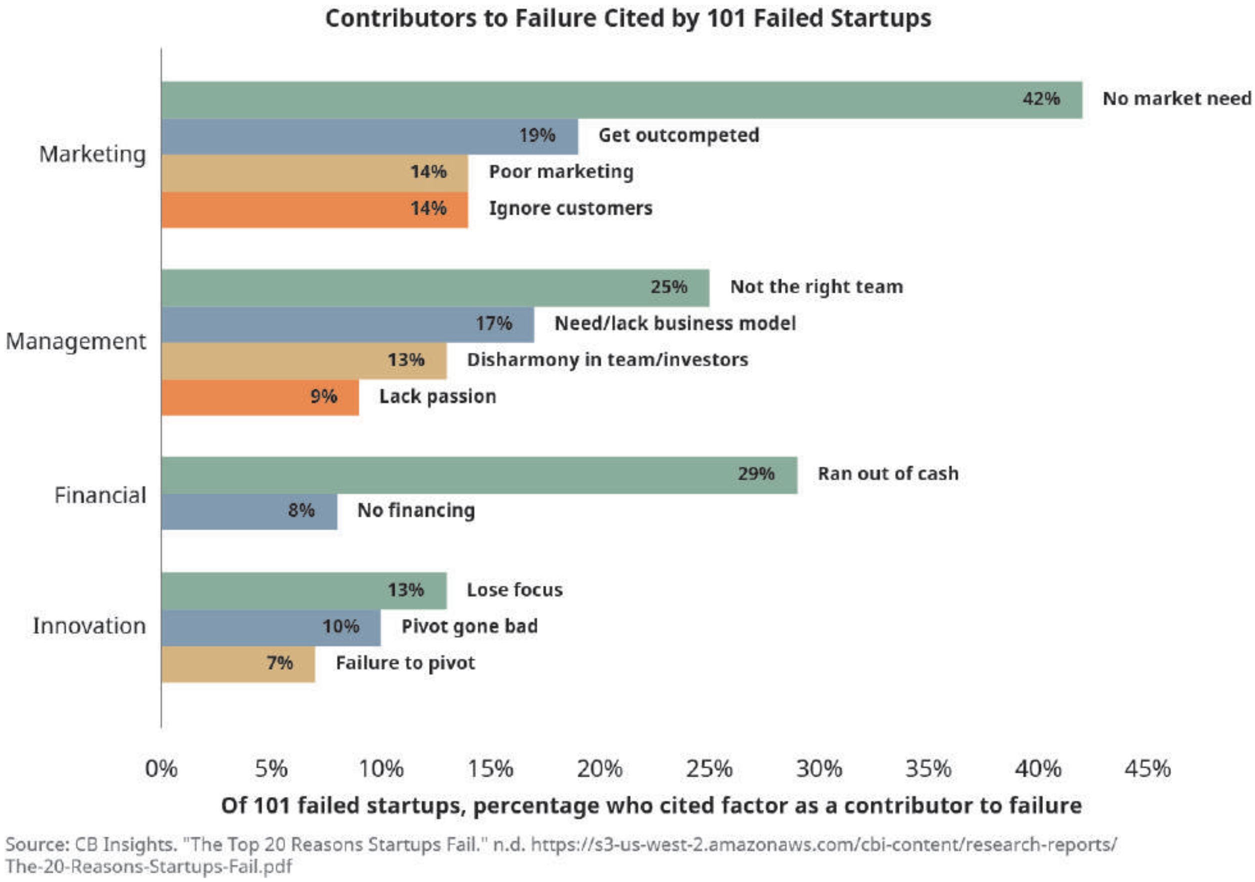


Figure 10.6 Startups that falter identify some common obstacles to success. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

In the following discussion, we expand on some of these reasons for failure and offer advice on how to avoid them. Considering the following failures will give you an idea of what may go wrong in a business but will also help you spot and correct them before you launch.

Marketing Failure

Some of the most common failures result from marketing missteps.

- *Lack of differentiation of product or service*. Creating or running a company with a me-too mentality and without a clear unique selling proposition or difference from other established businesses can be detrimental. Answering questions such as “Why should customers leave other companies to buy my product?” “What is a benefit I provide that no one else does?” and “If I open a yogurt parlor in a commercial area, what will help my business differentiate itself from all the other yogurt, ice cream, dessert, and fast food places?” can help create ways to be special rather than a me-too business. This also needs to be defined in your mission, within your products and their benefits, and a clearly defined competitive advantage that can be translated into a superior value proposition. The chapters on Entrepreneurial Marketing and Sales and Identifying Entrepreneurial Opportunity discuss competitive advantages and value propositions in more detail.
- *Missing the right customer*. Not reaching the target market can lead to failure. Perhaps for your travel tour

business, you targeted single people ages 18–34 who like to experience travel in a different way, but maybe your true target—the people who want to book your tours—are couples with children and those 50 and over. You would have sent out marketing communications to the wrong age group. Or, the right message is not being conveyed and your positioning is off, preventing you from connecting with your true consumer. Conducting market research as discussed in Entrepreneurial Marketing and Sales and testing your communication with various targets can help better define your customer.

Management Failure

These are some typical management challenges that can prove detrimental.

- *Passion wanes or not the right business*. Sometimes the reason a business fails is due to a simple reason: The founder has lost excitement over the business and is no longer interested in making it succeed. Other times, the problem may stem from not having the right focus or idea, which can come from a lack of awareness about trends in the market. Joel Delgado, a young entrepreneur who started El Paso's first escape room called El Paso Disaster Room 915 in 2015, developed this business with three of his friends right after college. Although the business was very well received by young people who wanted this new form of entertainment, a few years later, he decided to close down the business and pursue a career in teaching. His passion had waned. Sometimes, entrepreneurs get bored with their startup, but there are ways to keep the business exciting by changing the product offerings.
- *Fighting founders*. Not agreeing over the strategies and direction of a business can deter companies from moving forward. If the founders are not working together and disagree too much, this can help dissolve the business quickly. Differing points of view can be healthy for a business, as these can bring other complementing perspectives, but when conflict doesn't get resolved, it can be difficult to continue moving forward. Some business partners have found themselves ousted by their business partners because the relationships have suffered a deep strain. This happened to Steve Jobs in 1985 when he was let go by his own company. Often, it is difficult to assess when conflict will arise, so it is recommended that business partners work with people who have the same love for the business and its core values, even if they bring different strengths and temperaments to the table. This may reduce fights and sustain relationships. Having a contract in place that defines who is in charge of what part of the business, their compensation, and what happens if anyone departs, is a good way to ensure that the investment won't be lost if partners decide to part ways.
- *Lack of planning*. One of the surest roads to failure is to not have a business plan or marketing plan. Even using the lean startup method requires some sort of planning before embarking on the process. Planning helps business owners flesh out ideas and understand the business better. Following the business plan in Business Model and Plan and the marketing plan in Entrepreneurial Marketing and Sales can help solidify where the business is headed, whether its viable, and what resources are required to make it work. For example, imagine a business owner who opens a restaurant in an already-crowded market only to realize how much competition existed in the area. If the owner had researched and planned ahead, the venture could have been differentiated through the type of food offered, the location, or different promotional tactics to build clientele. Failure to plan in a situation like this can result in struggling to keep afloat and can lead to successive challenges. For example, the owner might raise prices to compensate for lower-than-expected revenue, but higher prices may drive away an already fragile customer base, and the venture may not be sustainable.

Financial Failure

Cash flow, debt, and capital are just some of the many financial factors that play a large role in startup success or failure.

- *Lack of cash*. Lacking cash to operate the business can trample its operations and lead to a quick decline. If there is no cash flow, it can also indicate that perhaps the business model is not working. For example, consider our fictional restaurant owner. A lack of customers means a lack of cash flowing in as revenue. Loans can provide some assistance while working to build the clientele, but loans can go only so far. If the business doesn't grow and develop a sustainable cash flow, its ability to operate will come to an end.
- *Too much debt*. Significant debt can hurt a business because it needs to pay back its lenders. In the previous example, if the restaurant owner takes on too much debt, it may struggle to pay it back due to its lack of cash flow.
- *Lack of capital*. Not having sufficient capital can deter the business from expanding or even from meeting customer demand. Having a clear business plan can help determine the financial requirements, which are the estimated sales and profits required for the successful attainment of goals. Financing for the business can come from an entrepreneur's own savings, bank loans, investors, and even friends and family. Having the right funding to start or grow a business can make or break the business. For instance, our restaurant owner would need enough capital to invest in kitchen equipment, appliances, and furniture to start the business. Undercapitalization in a startup could shut the business down before it even gets up and running. Once the business is running, ensuring that financial goals are met through metrics such as sales and profits can help prevent shortages of cash flow, which is essential to keeping a business alive.

Innovation Failure

Innovation can be tricky because it requires creativity, risk, and often some subjectivity, taking into consideration feelings and intuition in decision making. Lack of innovation and missteps in innovation can be obstacles to success.

- *Lack of innovation or failing to change effectively*. Companies that don't change their strategies, technology, or products run the risk of jeopardizing the business. Similarly, those that do change but not with the right adjustments risk failure. The build-measure-learn loop can help avoid these pitfalls by discerning what consumers really want and need by asking for their feedback.

Blockbuster, an instant hit out of the gates in the 1980s, failed to innovate, or pivot its business model, and went out of business. The video store revolutionized the media and movie industry by displaying empty boxes of its titles on shelves categorized by genre (the VHS tapes were kept behind the counter) and keeping late hours for night owls and last-minute weekenders wanting to catch a flick. Using a computer system to track videos as they were rented, most of its profit was made by the fees charged for late movie returns. In 1987, the company was bought by Wayne Huizenga, an American entrepreneur who owned several businesses in different industries and who developed Blockbuster into a successful business by modeling McDonald's approach. The enterprise grew from twenty locations to over 9,000 locations. Blockbuster was then acquired in 1993 by media giant Viacom in an intricate transaction. As streaming and related technology entered the market, Blockbuster failed to innovate by not making necessary pivots to its delivery of entertainment and so could not compete with new technology. Over the ensuing decade, it became more common to see Blockbuster stores with "store closing" banners, as shown in Figure 10.7, than it did to see a thriving store. There were other reasons why Blockbuster failed. Embedded with the lack of technology was the lack of fostering a culture of creativity from all of its employees, which hindered innovation. It lacked visionary leadership. It needed a culture of collaboration and teamwork to facilitate communication with stakeholders, such as employees, customers, and upper administration. Finally, it closed all but one of its stores in 2013.[28] By then, Netflix had completely changed the landscape of digital streaming services and left Blockbuster without a ticket to the show.

Figure 10.7 Blockbuster failed to change its distribution channel to cater to new generations of movie watchers. (credit: modification of “Blockbuster Store Closing, Ypsilanti Township, Michigan” by Dwight Burdette/Wikimedia Commons, CC BY 3.0)

ARE YOU READY?

Proactively Considering Failure

Consider the list of reasons for failure presented in Figure 10.6. Come up with solutions to each of those reasons, focusing on a business of your choice.

- How would you avoid the failure?
- What strategies or goals can you have in place to avoid the pitfalls of failure?

Fear of Failure

Even the fear of failure can be enough to lead a business to fail. Fear can freeze entrepreneurs and force them into a corner instead of advancing their businesses; it can freeze them from reaching potential clients and being profitable. When companies struggle, the owners may experience many emotions, such as pain, grief, shame, humiliation, self-blame, anger, and hopelessness. Business failure is hard to separate from personal failure, as the business is often associated with the identity of the entrepreneur. Managing these emotions can

28 Jeanine Poggi. “Blockbuster’s Rise and Fall: The Long, Rewinding Road.” *TheStreet*. September 23, 2010. https://www.thestreet.com/story/10867574/1/the-rise-and-fall-of-blockbuster-the-long-rewinding-road.html

help business owners heal and continue moving forward to their next business. Reaching out for help to a trusted mentor or therapist can help provide guidance in dealing with these feelings.

There are likewise many stories of entrepreneurs who, despite their fears, continued working toward their goal and were successful. They kept going, determined that fear would not run their lives. Tony Robbins, author and serial entrepreneur, says that people are afraid of failure because it is painful, and people try to avoid pain and suffering at all costs. "Failure," he says, "is the ultimate loss."[29] But overcoming fear doesn't have to be painful if you understand it as a program or detrimental thinking running in your mind. People are hardwired to believe they are not good enough or can't do it. These patterns can be embedded in people's minds and can deter creativity and success. Some signs of fear of failure are listed in Table 10.3.

Signs of Fear of Failure
• Believing you are not good enough, you don't belong, or you're not smart enough to be successful. • Feeling that you have to be perfect in everything you do and have a need for approval. • Not wanting to adapt or be flexible. Not wanting to take on difficult clients or projects. • Feeling anxious about performing, leaving things for later, and not following through with plans.

Table 10.3 Fear can freeze up entrepreneurs. The important thing is to let go of old thinking patterns and adopt a positive outlook. It also helps to move forward despite fear and have mentors who can help deal with negative thoughts and emotions.

Fear of failure often stems from thoughts of inadequacy or a belief that you don't have the experience and skills necessary to succeed, that you're not smart enough, and so on. Thoughts like these can prevent a person from starting or advancing their business. Individuals with a high level of stress about failure tend to lack self-esteem, have anxiety, be perfectionists, and tend to avoid new or unfamiliar things at all costs.[30] Fortunately, these traits and behaviors can be controlled and conquered.

Most entrepreneurs will tell you that, at some point, they had to fight their fears before they had any success.

Most entrepreneurs who succeed will tell you that behind every success there were many failures. Many people in general think that those who are great and successful were born that way. But that is simply not true.

Take Michael Jordan, for example. One of the most successful basketball players of all time, with five championship rings and thousands of points and assists, Jordan often said that he owed his success to failure. "I've missed more than 9,000 shots in my career. I've lost almost 300 games. Twenty-six times I've been trusted to take the game-winning shot and missed. I've failed over and over and over again in my life. And that is why I succeed."[31] Michael Jordan, a kid who didn't make the varsity team in his high school, got his act together and propelled himself to stardom because he didn't give up when he failed. The same goes for entrepreneurs: Just because it didn't work the first time, it doesn't mean that they can't try again.

James Dyson, founder and inventor of the Dyson vacuum cleaner, had failed 5,126 times before he came up with his Dual Cyclone vacuum cleaner in 1993, fifteen years after he created the first version. When asked about how failure helped him, he said, "Failure is interesting—it's part of making progress. You never learn

29 Team Tony. "Overcoming the Fear of Failure." *Tony Robbins*. n.d. https://www.tonyrobbins.com/stories/overcoming-fear-failure/
30 Mind Tools Content Team. "Overcoming Fear of Failure." *MindTools*. n.d. https://www.mindtools.com/pages/article/fear-of-failure.htm
31 The Greatest Team. "Quote: Michael Jordan on Success through Failure." *The Greatist*. June 10, 2012. https://greatist.com/fitness/quote-michael-jordan-success-through-failure

from success, but you do learn from failure. When I created the Dual Cyclone vacuum, I started out with a simple idea, and by the end, it got more audacious and interesting. I got to a place I never could have imagined because I learned what worked and didn't work."[32] Dyson also says that he continuously embraces risk and failure, and allows his employees to explore that: "Nothing beats the thrill of invention. Letting people go out and try their ideas, getting them totally involved, and unleashing new thinking. They're not bound to any methodology—in fact, the stranger and riskier, the better."[33]

Fear of Failure around the World

According to research, fear of failure is influenced by people's upbringing and cultural backgrounds. The **Global Entrepreneurship Monitor (GEM)**, an organization that researches entrepreneurship around the world, has studied this topic. According to its 2018–2019 report, Americans are not as afraid to fail in business as people from many other countries are.[34] This report includes those who would like to start a business but feel stuck because of fear of failure. Fear of failure is highest in Greece, Italy, Russia, and Cyprus, and lowest in Latin America and Africa. Usually, the fear is lowest in countries where there are few jobs and where people have to become entrepreneurial to survive.

WHAT CAN YOU DO?

GEM Data

Go to the Global Entrepreneurship Monitor at http://www.gemconsortium.org/ and look up the report on entrepreneurship for the United States. Compare it with two other countries.

- What are the differences and similarities between the countries?
- What can you do to address some of the factors in the US that hinder entrepreneurial development? What can be done to improve entrepreneurial conditions in the two other countries you examined?

GEM also reports that women are usually more afraid of failure than men and show less confidence in their abilities (Figure 10.8). The research also shows that women tend to open ventures in consumer industries, whereas male-driven startups are often in manufacturing and tech sectors, and men receive more capital and incentives to open those businesses. This can be attributed to the lack of women in science and tech industries.[35] Other studies corroborate GEM's findings, showing that women are more afraid to start a business, they don't receive as much funding, and feel they have to prove themselves more than men to be taken seriously.[36]

32 Nadia Goodman. "James Dyson on Using Failure to Drive Success." *Entrepreneur*. November 5, 2012. https://www.entrepreneur.com/article/224855

33 Madison Malone-Kircher. "Dyson on the 5,126 Vacuums That Didn't Work—and the One That Finally Did." *New York Magazine*. November 22, 2016. http://nymag.com/vindicated/2016/11/james-dyson-on-5-126-vacuums-that-didnt-work-and-1-that-did.html

34 Global Entrepreneurship Monitor. "Fear of Failure." 2018–2019. *GEM*. https://www.gemconsortium.org/report

35 Catherine Clifford. "Lack of Confidence, Fear of Failure Hold Women Back from Being Entrepreneurs." *Entrepreneur*. July 31, 2013. https://www.entrepreneur.com/article/227631

36 Ruth Simon. "Women Started Smaller Percentage of Businesses in 2014." *The Wall Street Journal*. March 13, 2015. https://www.wsj.com/articles/women-started-smaller-percentage-of-u-s-businesses-in-2014-1431560888

Figure 10.8 Research shows that women tend to be more afraid of failure and have less confidence in their abilities than men. Getting support from business organizations, programs, and mentors can help women build their self-assurance to begin or grow an enterprise. (credit: “Accomplished Achievement Agreement” by “rawpixel”/Pixabay, CC0)

What Failure Teaches You

Some would argue that, in reality, failure does not exist. There is only perceived failure, or obstacles that can become steps up the ladder to a better outcome. The importance in failing lies in learning how to get back up again. As Eric Ries dove into failure with his first company and felt the deep pain and disappointment of having to let go of an unsuccessful idea, he applied his lessons to create his new virtual reality company IMVU. IMVU then became a very successful experiment from which he derived the lean startup method. He was able to pinpoint his shortcomings and find ways to better himself and his performance. With his new company, he was able to get the product to market faster without it being perfect and ask for much-needed feedback from customers that he hadn’t received before.

Converting Lessons Learned to Success

Most successful business owners will tell you that success didn’t come to them easily. They had to persevere in pursuit of their goals to attain them. Converting their failures to lessons often led them to higher success than they had imagined. Entrepreneurs who can turn their obstacles into positive lessons can resurrect from failure.

Take Evan Williams, a visionary who launched a software tool to help users easily publish blogs. That venture, Blogger.com, was launched in 1999 and purchased by Google in 2003. The next year, Williams decided to establish Odeo, a platform for creating and sharing podcasts. Apple had been working on a similar platform and shared it earlier on iTunes to the demise of Odeo. Williams didn’t want to go head to head with iTunes, as this could potentially destroy his company, so he found a way to go in a different direction and establish a new way of sharing status updates and other data. Williams took that failure, and with a few friends, co-founded Twitter. We all know how that worked out: Twitter is one of the most popular microblogging tech platforms.[37]

LINK TO LEARNING

Check out Evan Williams's TedTalk (https://openstax.org/l/52TedTalkWill) where he takes you through iterations from actual Twitter users.

Kathryn Minshew, shown in Figure 10.9, also experienced failure but has learned from it. In 2010, she quit her job to create Pretty Young Professionals (PYP). She invested $25,000 of her own money to develop a networking platform for women who were smart and passionate about their careers. After a few months, she and the three other co-founders started to disagree on some issues, including their approach to advertising. As they hadn't completely formalized the ownership of PYP, two of the founders lost their investments, including Minshew. After experiencing the loss of her investment, her friendships, and the original idea, Minshew persevered with a new opportunity and established The Muse. This platform is similar to PYP but added job listings, workshops, and advice. Currently, the site has over 4 million users and is a major competitor of LinkedIn. Minshew didn't let her first disappointment prevent her from starting a new venture. She applied the lessons learned in building the original platform to the creation of a new one—with the right contracts and right people in place.[38] Minshew now speaks at business conferences and events, sharing her mistakes and how she used them to lift herself up to launch a new venture properly. She hopes that her experience helps other entrepreneurs avoid the pitfalls she went through so they can be as successful.

37 Paige Cooper. "28 Twitter Statistics All Marketers Need to Know in 2019." *Hootsuite*. January 16, 2019. https://blog.hootsuite.com/twitter-statistics/

38 Doria Lavagnino. "Muse CEO and Co-Founder Kathryn Minshew: Journey of an Entrepreneur." *Centasi*. August 24, 2017. https://centsai.com/entrepreneurship-blogs/muse-ceo-co-founder-kathryn-minshew-journey-entrepreneur/

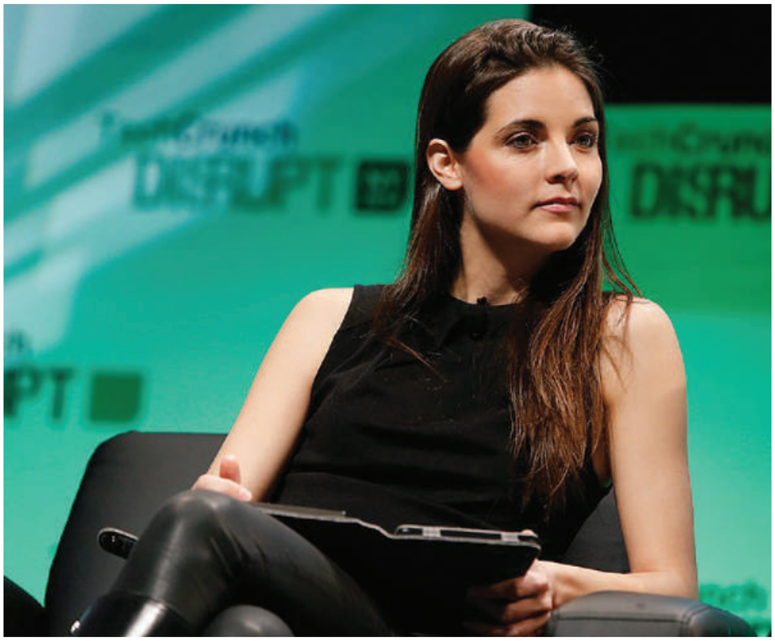


Figure 10.9 Kathryn Minshew, co-founder of The Muse, used the lessons from her first business's failure and built a successful platform for professional networking. (credit: modification of "Kathryn Minshew" by "Techcrunch"/Wikimedia Commons, CC BY 2.0)

Being able to learn from different types of failure is as important as experiencing success because you get to know your strengths and how to leverage them. Failures can be seen as stepping stones rather than embarrassments. Feeling comfortable takes practice. Table 10.4 shares several tips on dealing with these dynamics.

Tips for Converting Lessons to Successes
• Let go of the fear of failure: It is not as bad as you think. • Experiment with your business and try new things; take risks if necessary. • Go for it, even if you're not ready. Listen to your gut. • Ask for feedback, and don't be afraid to hear negative things. • Be willing to change when things are not working out. • Learn from others and be willing to ask for help.

Table 10.4

Coping with Fear

When coping with fear of failure, there are two strategies that entrepreneurs can use. The first way to reduce fear of failure is to modify your business strategy by changing the target outcomes for your business. Instead of aiming to make $50,000 in the first six months, you can be open to the idea of a leaner start, learning about your customers and how best to serve them. Learning/growth goals can be just as valuable as hitting a revenue target in terms of overall success and longevity. Also, if a goal is not met, don't consider it a total failure: Refocus and ask yourself what you learned from the experience and how to apply that knowledge to a revised goal. More than likely you will find this experience has enhanced your toolbox to help you make changes within the business or start a new one.

A second way to reduce high stress is to practice some sort of meditation or breathing exercise that can help lower the anxiety created by fearful thinking. Reaching out to a mentor, support group, therapist, or counselor can also help alleviate fearful thinking.

10.3 The Challenging Truth about Business Ownership

Learning Objectives

By the end of this section, you will be able to:

- Explain the pros and cons of business ownership before you launch
- Understand current trends in entrepreneurship in the US
- Determine the challenges women face in entrepreneurship and what resources they can use to overcome them
- Determine the challenges minority entrepreneurs face and resources available for them

People usually have different reasons for starting a business. Some of the reasons—other than the idea they've hit upon—include the freedom to set their own hours, spend more time with family, be their own boss, and make money. However, in many cases, they will probably work more than planned, be challenged to find the work-life balance, face fears and doubts, and perhaps struggle to make ends meet for the first few months or years. Prior to launch, they will need the support of family, friends, and mentors to understand the limitations of time and the pressures they face.

Pros and Cons of Business Ownership

Table 10.5 lists the positives and negatives that should be considered prior to opening a business and throughout its operation. Positives of entrepreneurship include having the freedom and independence to expand your skills and develop your own ideas. Instead of working for another organization on projects and ideas that are not your own, you get to serve people in a way that feels right for you. You also have the opportunity to make a profit and have a better lifestyle. Having the freedom to set your own schedule and work at your own pace can be very satisfying as well.

On the opposite side, those "freedoms" translate into being in charge of the business and the significant responsibility that entails. You must resolve issues that arise every day, such as dealing with employees, customers, production, marketing, and financing, among others. Most of the time, you wear many hats, especially during the venture's early lifecycle stages, and most entrepreneurs usually work more hours than anticipated. In addition, you must deal with losses and risk if things don't go well. The important thing to keep in mind is that all of the negative aspects have solutions and can even be prevented if planning, mentorship, and a good support system are in place, which can alleviate many of the stresses that entrepreneurs experience. Also, having attainable goals in creating awareness of the business, number of clients, and sales or profit can be beneficial in alleviating some of that pressure.

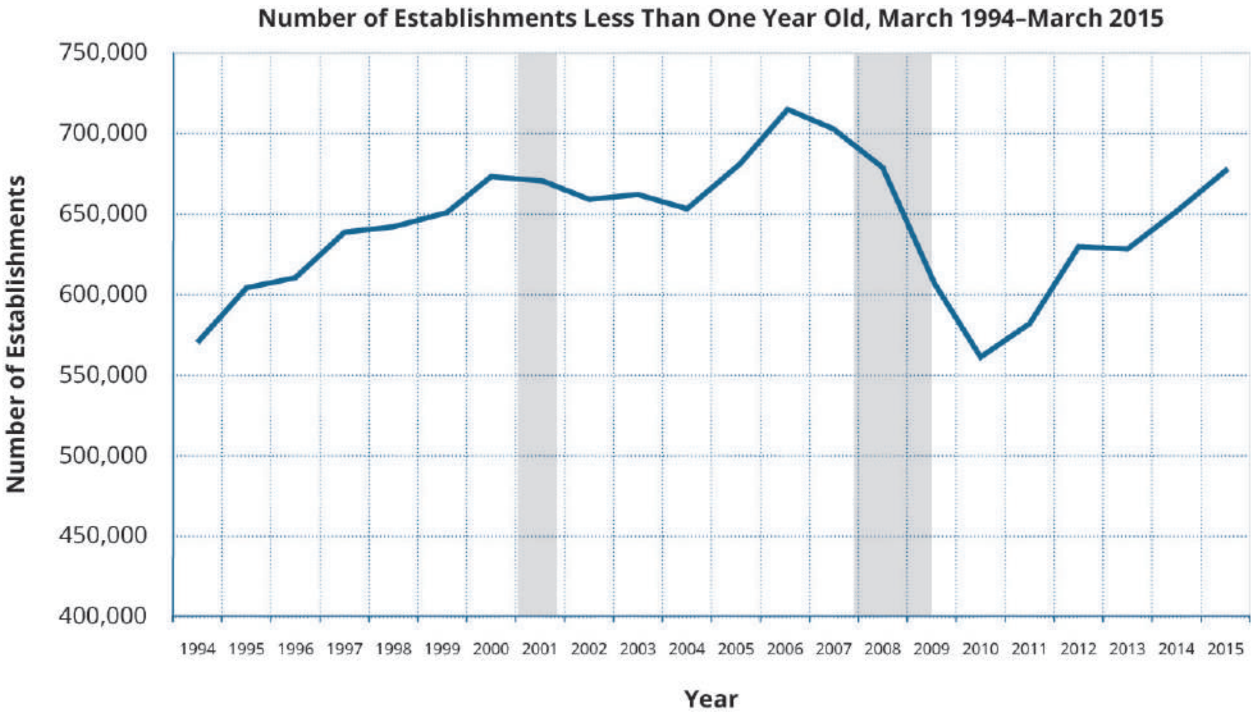
Pros and Cons of Business Ownership

Pros	Cons
• Being autonomous, being your own boss, expanding ideas, enjoying creative freedom • Lifestyle, making your own schedule, flexibility • Satisfied with career • Serving customers and employees • Profit • Being known in the community	• Being in charge, resolving issues, hiring/firing employees, and wearing many hats • Dealing with stress, time constraints, and management • Lack of focus, loss of passion • Customer and employee complaints • Money/cash flow problems • Must deal with losses and financial risk

Table 10.5

Entrepreneurship and Competition in the US

Entrepreneurs operate in an unbelievably competitive landscape. Although competition helps create better products and services, it also places many stresses on a business owner who must compete with new, more flexible businesses that may have lower prices and better products. As shown in Figure 10.10, the number of new establishments that are less than one year old has increased over the past two decades from 1994 to 2015. There was a dip during the 2009 recession, but the trend continued after 2011, and the number of businesses increased again. This means more competition for businesses that are already established.



Source: "Chart 1. Number of Establishments Less Than 1 Year Old, March 1994–March 2015." Entrepreneurship and the U.S. Economy. Business Employment Dynamics. United States Department of Labor. April 28, 2016.

Figure 10.10 The number of new businesses usually rises and falls with the economy. This graph shows that the number of new establishments has risen in recent years.[39] (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

The number of jobs created by these young establishments has also decreased in this period, which affirms the likelihood that entrepreneurs are wearing many hats in their own businesses. Figure 10.11 charts this trend.

39 Bureau of Labor Statistics. "Entrepreneurship and the US Economy." *United States Department of Labor*. April 28, 2016. https://www.bls.gov/bdm/entrepreneurship/entrepreneurship.htm

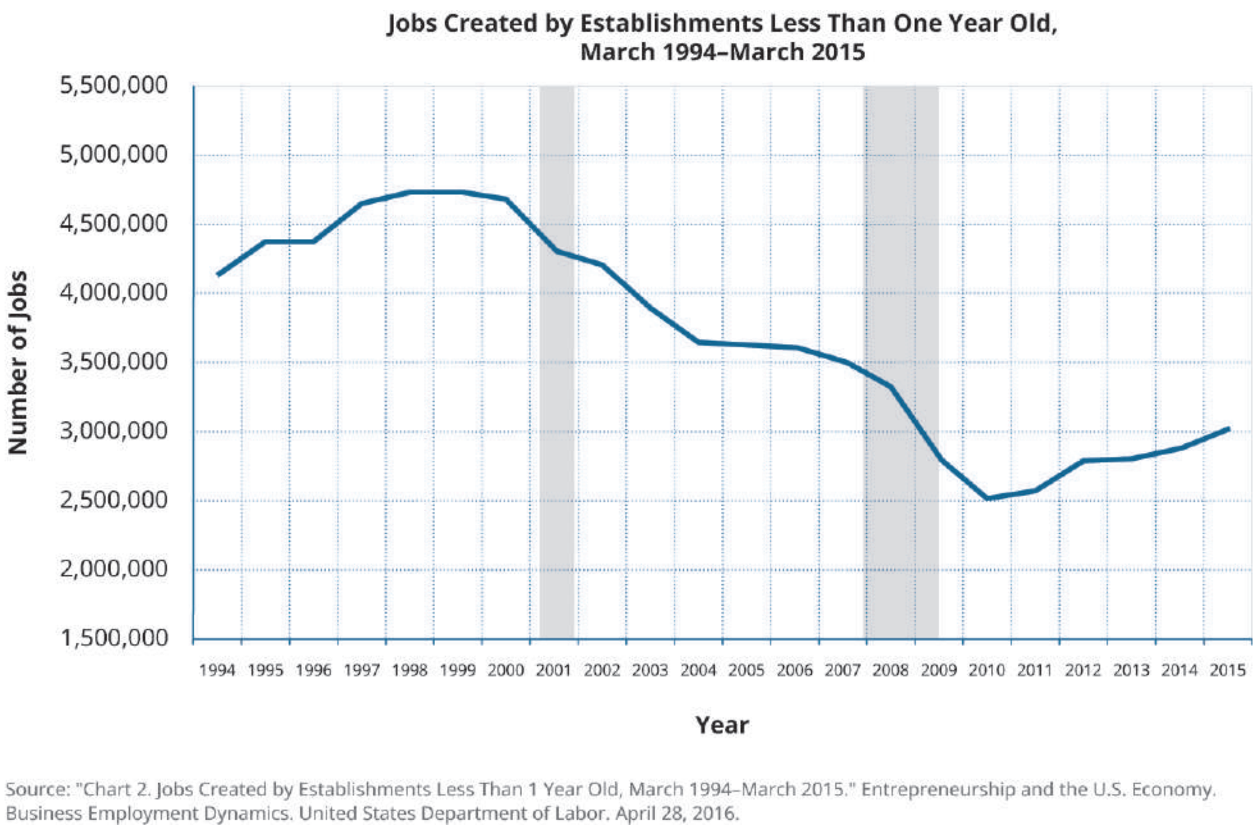
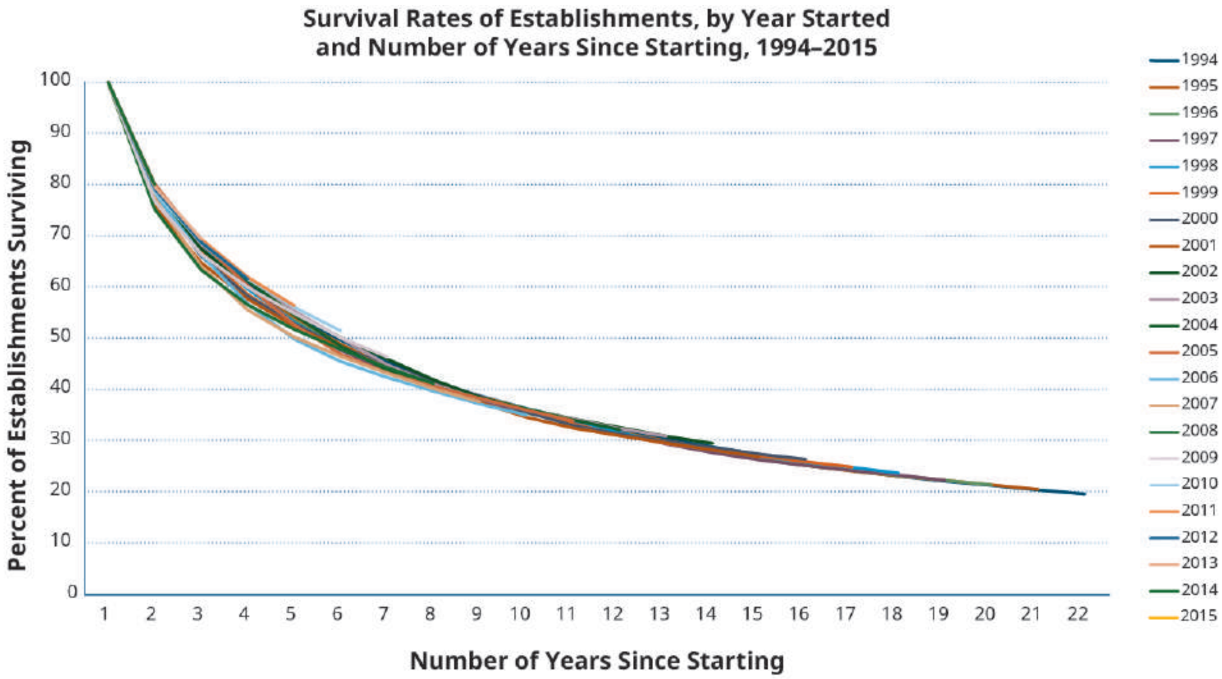


Figure 10.11 While the number of new business establishments has risen, the number of jobs and the survival of businesses (following) have decreased during the same period.[40] (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

As you've learned, only about 20–30 percent of businesses succeed to the five- or ten-year mark. Figure 10.12 shows that only half of businesses survive to the five-year mark, and only 20 percent are sustained for two decades. Their failures may be due to a number of factors such as cash flow problems, lack of passion, lack of support, lack of innovation, difficulty adapting to new technologies or customer demand, and environmental factors that can influence a business as well, such as the economy, trends, regulations, or sociocultural changes. Therefore, it's important for entrepreneurs to research their internal as well as their external environments before launching. The chapters on Identifying Entrepreneurial Opportunity and Entrepreneurial Marketing and Sales take a look at such research, as it pertains to both the entrepreneur and the marketing environment respectively.

40 Bureau of Labor Statistics. "Entrepreneurship and the US Economy." *United States Department of Labor*. April 28, 2016. https://www.bls.gov/bdm/entrepreneurship/entrepreneurship.htm



Source: "Chart 3. Survival Rates of Establishments, by Year Started and Number of Years Since Starting, 1994–2015, in Percent." Entrepreneurship and the U.S. Economy. Business Employment Dynamics. United States Department of Labor. April 28, 2016.

Figure 10.12 Survival rates of businesses from 1994–2015. This graph shows that as years go by, fewer businesses stay open.[41] (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Challenges of Business Ownership for Women

Challenges for business owners can be many. Female entrepreneurs, however, can face additional hardships. These can range from not being able to secure financing for their businesses, having a hard time breaking into an industry, and dealing with fears of starting and growing a business, and not being taken seriously.

Current research shows that the importance of female entrepreneurship is key to economic success. Women own 40 percent of the country's businesses,[42] generating over $1.4 trillion in sales.[43] Women entrepreneurs are closing the gender gap, as their ventures have grown substantially in the past few years. In the past two years, women entrepreneurship rates have gone up by 10 percent each year, compared to men's 5 percent growth. This surge has been spurred by increased available resources, including mentorship, funding, and programs to help women succeed.[44] Nonetheless, there are still great challenges to overcome, as women move into the next generation of business ownership. Some of the main challenges are:

- *Difficulty gaining entry in certain industries*. Women have made great strides in business, but they still face many obstacles, especially in certain industries. Women tend to be underrepresented in specific areas, notably in the tech industry, where they run only 9 percent of businesses.[45] Women tend to be underpaid

41 Bureau of Labor Statistics. "Entrepreneurship and the US Economy." *United States Department of Labor*. April 28, 2016. https://www.bls.gov/bdm/entrepreneurship/entrepreneurship.htm

42 Bernard Meyer. "Business Woman Challenges, Examples and Opportunities in 2107 and Beyond." *InvoiceBerry*. June 19, 2017. https://blog.invoiceberry.com/2017/06/business-woman-challenges-examples-opportunities/

43 National Association of Women Business Owners (NAWBO). "Women Business Owner Statistics." *NAWBO*. 2017. https://www.nawbo.org/resources/women-business-owner-statistics

44 Elaine Pofeldt. "Why Women Entrepreneurs Will Be the Economic Force to Reckon with in 2017." *CNBC*. February 28, 2017. https://www.cnbc.com/2017/02/28/why-women-entrepreneurs-will-be-economic-force-to-reckon-with-in-2017.html

45 Sahil Raina. "Research: The Gender Gap in Startup Success Disappears When Women Fund Women." *Harvard Business Review*. July 19, 2016. https://hbr.org/2016/07/research-the-gender-gap-in-startup-success-disappears-when-women-fund-women

in tech positions, they experience sexism, and they are often passed over for promotions, especially if they have families with young children. So, if there are no female role models, it is difficult for women to follow an entrepreneurial path that is already full of obstacles. Although young girls and women desire to study and expand their careers, historically, they have not been presented with the opportunities and encouragement to do so, especially in STEM. By the time they get into college, the number of women in these careers—which can be rich in entrepreneurial opportunities—is very small. However, more efforts are being made today to support young girls interested in scientific, technological, and mathematical careers.

- *Lower sales and fewer employees*. Women overall tend to struggle more to keep their businesses afloat, as they have fewer employees,[46] less revenue, and less profit than male-owned businesses. Only 2 percent of female-owned businesses make over $1 million in sales. Male-owned businesses, on the other hand, are 3.5 times more likely to hit that revenue target.[47] Some of the reasons why women experience this is because women may enter entrepreneurship part time, often striving to sustain a decent family work balance, which is difficult when children, especially young children, are part of the equation. This set-up usually includes one employee, who is the entrepreneur herself, and she may have attained her goals without wanting to make millions. Time, flexibility, and work-life balance can be reasons women become entrepreneurs, and they are happy with their goals of making some money while taking care of their family and household. Lack of experience in business or managing a family business, and lack of access to capital are also reasons for the lower metrics.[48]
- *Less access to capital*. Regardless of their success and prowess, women still have a harder time securing funding for their businesses. A recent Kauffman Foundation survey determined that more than 72 percent of women don't have the access to capital they need.[49] Nirupama Mallavarupu, founder of MobileArq says, "As a woman entrepreneur with a focus on helping non-profits and schools, it has been difficult to get investors. We have turned this around by pursuing customer acquisition organically and relying on direct revenues instead of investment growth."[50] Women usually don't ask for funding, or if they do but are turned down, they turn to funding from family and friends. They are more likely to finance their ventures this way than men.[51]
- *Not taken seriously*. Sometimes it's not that women don't have the opportunities, money, or mentorships to start a business: Sometimes, women are just not taken seriously. Research by Freshbooks Accounting and Software firm and Research Now asked 2,700 entrepreneurs about gender discrimination and the wage gap that exist today. Thirty percent of women pointed out that they are not taken seriously as business owners, as they must work harder than their male counterparts and have to charge less to get a client.[52] Emily Harsh, owner of Heart Move Collective, comments in her blog, "Because I am in the fitness

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46 Michael J. McManus. "Women's Business Ownership: Data from the 2012 Survey of Business Owners." *US Small Business Administration Office of Advocacy*. May 31, 2017. https://www.sba.gov/sites/default/files/advocacy/Womens-Business-Ownership-in-the-US.pdf

47 Eilene Zimmerman. "Only 2% of Women-Owned Businesses Break the $1 Million Mark—Here's How to Be One of Them." *Forbes*. April 1, 2015. https://www.forbes.com/sites/eilenezimmerman/2015/04/01/only-2-of-women-owned-businesses-break-the-1-million-mark-heres-how-to-be-one-of-them/#2a53233727a6

48 Robert W. Fairlie and Alicia M. Robb. "Gender Differences in Business Performance: Evidence from the Characteristics of Business Owners Survey." *SpringerLink*. May 5, 2009. https://link.springer.com/article/10.1007/s11187-009-9207-5

49 Elaine Pofeldt. "Why Women Entrepreneurs Will Be the Economic Force to Reckon with in 2017." *CNBC*. February 28, 2017. https://www.cnbc.com/2017/02/28/why-women-entrepreneurs-will-be-economic-force-to-reckon-with-in-2017.html

50 Bernard Meyer. "Business Woman Challenges, Examples and Opportunities in 2107 and Beyond." *InvoiceBerry*. June 19, 2017. https://blog.invoiceberry.com/2017/06/business-woman-challenges-examples-opportunities/

51 Elaine Pofeldt. "Why Women Entrepreneurs Will Be the Economic Force to Reckon with in 2017." *CNBC*. February 28, 2017. https://www.cnbc.com/2017/02/28/why-women-entrepreneurs-will-be-economic-force-to-reckon-with-in-2017.html

52 "New Research from FreshBooks Discovers a 28% Wage Gap among Self-Employed Men and Women." *FreshBooks*. n.d. https://www.freshbooks.com/press/data-research/women-in-the-workforce-2018?ref=10400&utm_source=sas&utm_medium=affiliate&utm_campaign=314743&sscid=31k3_f8pv3

industry and female, I am often not taken seriously as a professional. I think the number one most important thing you can do as a woman fighting to pave your own path is to continually stay authentic."[53]

- *Resources*. Fortunately, there are many resources that women can take advantage of. Organizations such as the Women's Business Center of the Small Business Administration, the National Association for Women Owners, the Female Entrepreneur Association, Ladies Who Launch, Minority Business Development Agency, the National Association of Professional Women, and the Women's Business Enterprise National Council strive to help women succeed in all industries by providing loans and programs that prepare them for a competitive landscape. Mentoring by other women has also proven to be effective in women's success in entrepreneurship.[54] Having peers that can help and strong mentors can make a difference in the outcome of a business.

Other helpful tips to counteract the challenges facing women entrepreneurs include being assertive, being authentic, networking, and developing a thick skin for rejections and other challenges. Facebook COO Sheryl Sandberg, in her book *Lean In*, states that "being confident and believing in your own self-worth is necessary to achieving your potential" and she encourages women entrepreneurs to ask themselves: "What would you do if you weren't afraid?"[55]

Women bring great qualities to entrepreneurship such as strong leadership, as well as management, time, multitasking, and listening skills. Women also have a collaborative approach to relationships that works well in many industries.[56]

Challenges of Business Ownership for Minorities

Entrepreneurs from minority groups encounter additional challenges. Minority groups are a strong force in the economy of the country, yet they still experience additional challenges that sometimes prevent them from succeeding in their businesses. These can range from having lower capital access[57] due to little credit history, small or nonexistent business networks, and lower business knowledge.[58] According to the Census Bureau, minorities own about 29 percent of US businesses.[59]

Hispanics[60] comprise 17 percent of the population and own approximately four million (13%) companies in the US with $661 billion in revenue. From 2007 to 2015, business revenue grew 88 percent for Hispanics, which means that they have more power to employ more people to provide goods and services to a wider audience, and to purchase from other vendors. Given its growth and current size, this group is vital to the health of the economy.[61] Unfortunately, research shows that if measured by financial outcomes, Hispanics still struggle to succeed in business ventures due to a lack of funding, less managerial/business education, and lack of

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53 Bernard Meyer. "Business Woman Challenges, Examples and Opportunities in 2107 and Beyond." *InvoiceBerry*. June 19, 2017. https://blog.invoiceberry.com/2017/06/business-woman-challenges-examples-opportunities/

54 Robin L. Laukhuf and Timothy A. Malone. "Women Entrepreneurs Need Mentors." *International Journal of Evidence Based Coaching and Mentoring* 13(1): 70–86. 2015. http://ijebcm.brookes.ac.uk/documents/vol13issue1-paper-05.pdf

55 Sheryl Sanders. *Lean In: Women, Work, and the Will to Lead*. (New York: Knopf. March 12, 2013).

56 S. Mohan Kumara, H.S. Chandrika Mohana, Vijaya C., and Lokeshwari N. *International Journal of Current Engineering and Technology* (Special Issue 1): 100–104. 2013. http://inpressco.com/wp-content/uploads/2013/09/Paper20100-104.pdf

57 Minority Business Development Agency. "Access to Capital Is Still a Challenge for Minority Business Entrepreneurs." *US Department of Commerce: Minority Business Entrepreneur*. March/April 2010. https://www.mbda.gov/news/blog/2010/07/access-capital-still-challenge-minority-business-enterprises

58 David Kiger. "Minority Entrepreneurs Face Challenges in Business Development." *Business 2 Community*. April 2, 2016. https://www.business2community.com/small-business/minority-entrepreneurs-face-challenges-business-development-01497508

59 Aleks Merkovich. "30 Insightful Small Business Statistics." *FitSmallBusiness*. March 18, 2019. https://fitsmallbusiness.com/small-business-statistics/

60 "Of Hispanic or Latino Origin" as used in the 2010 Census refers to a person of Cuban, Mexican, Puerto Rican, South or Central American, or other Spanish culture or origin regardless of race. https://www.census.gov/prod/cen2010/briefs/c2010br-02.pdf

mentorship.[62] A higher rate of foreign-born entrepreneurs can experience these challenges due to the lack of networks and financial history in the country.[63]

African Americans make up 14 percent of the total US population, and their businesses represent about 7 percent of total businesses. Although they are opening businesses faster than their Caucasian counterparts, their businesses, as well as Hispanic businesses, tend to have higher failure rates than Caucasian- and Asian-owned businesses.[64] Similar to Hispanics, African Americans tend to lack funding, managerial/business education, and mentorship.

Asian Americans make up 5 percent of the population and own just over 4 percent of the businesses in the country. Although they are considered minorities, Asian Americans tend to be better educated and have more access to capital than Hispanic Americans and African Americans.[65]

Organizations such as the Hispanic, Black, and Asian American Chambers, the Minority Business and Development Agency (MBDA), and the Small Business Administration (SBA) have developed programs to help minority entrepreneurs succeed in various ways. These organizations hold workshops once or twice a month to provide helpful information and business plan templates so owners work through their preparation to launch a venture. Chambers are also helpful in matching companies with banks for loans based on their needs and industries. The 8a certification is also facilitated by the Chambers and the MBDA, and provides disadvantaged businesses with an assistance program.

LINK TO LEARNING

Go to the MBDA's page on the 8(a) Business Development Program (https://openstax.org/l/52MBDA) and read about the requirements and benefits of 8a certification. You can also see that the MBDA offers access to grant and loan programs, and many other helpful resources.

Disadvantaged businesses are those that are small, owned by someone economically disadvantaged (a person who has less than $250,000 in personal net worth, which includes assets such as cash, home, car, and real estate minus liabilities such as mortgages, credit card debt, and car and bank loans), with an owner demonstrating that the business can be successful. This program helps minority business owners access finances, mentors, counselors, and management assistance, among other resources.[66] In addition to this support, some organizations, such as the SBA, provide certifications on various business topics on marketing, finance, accounting, management, and production that usually take the form of short classes for business owners to acquire business acumen. These programs help entrepreneurs gain needed knowledge, grow

61 Geoscape. "Hispanic Businesses and Entrepreneurs Drive Growth in the New Economy: Third Annual Report." *Geoscape*. 2015. https://ushcc.com/wp-content/uploads/2015/11/HispanicBusinessReport2015_Final_Sept19.pdf

62 Denisse Olivas. *Entrepreneurship Success: A Hispanic Point of View*. Center for Hispanic Entrepreneurship. University of Texas at El Paso. Proceedings from the International Conference of Facets Doing Business in Emerging Markets. July 2016. https://www.utep.edu/business/_Files/docs/cfhe/newentrepreneurship-success-presentation-cfhe.pdf

63 Geoscape. "Hispanic Businesses and Entrepreneurs Drive Growth in the New Economy: Third Annual Report." *Geoscape*. 2015. https://ushcc.com/wp-content/uploads/2015/11/HispanicBusinessReport2015_Final_Sept19.pdf

64 "Race." *Kaufmann Foundation*. n.d. https://www.kauffman.org/microsites/state-of-the-field/topics/background-of-entrepreneurs/demographics/race

65 "Race." *Kaufmann Foundation*. n.d. https://www.kauffman.org/microsites/state-of-the-field/topics/background-of-entrepreneurs/demographics/race

66 Minority Business Development Agency. "What Is the 8(a) Business Development Program." *US Department of Commerce*. n.d. https://www.mbda.gov/news/blog/2012/03/what-8a-business-development-program

professionally, and connect with people as they go through their entrepreneurial journeys.

LINK TO LEARNING

Go to the US Department of Labor's blog post on women business owners (https://openstax.org/l/52DOLWomenBus) and look at some of the facts listed about women business owners. Which ones surprised you the most?

10.4 Managing, Following, and Adjusting the Initial Plan

Learning Objectives

By the end of this section, you will be able to:

- Explain the difference between a business plan and a lean plan
- Know how to develop a lean plan quickly and accurately
- Run the build-measure-learn loop

In this chapter, we've discussed how to start the imperfect business using the lean startup approach. We've looked at the build-measure-learn loop and how to test an MVP. We've also covered how to deal with fear of failure and how to overcome negative thinking. In addition, we've covered how minorities can tap into resources to help them be successful. Now it's time to build the lean plan to help you launch your venture.

As you must realize, having a lean plan is important to executing its process. A **lean plan** follows the path of lean methodology. It is a brief business plan shown to potential investors and employees that is a fast and effective way to set, manage, and evaluate goals and strategies in a business. Figure 10.13 shows its components.

Traditionally, a business plan requires a detailed document of the company's background, the target, objectives, financials, and marketing strategies. Developing this usually takes a long time, from a few months to a year, as you will see in Business Model and Plan. A full business plan requires robust information as it's developed for internal purposes, for banks or investors who need proof that the business is a good investment, and for other stakeholders. In contrast, a lean plan is short and includes only specific information, sufficient to go through the build-measure-learn loop. This plan is where you clarify initial ideas about the product to help you work through the loop and to share with potential investors and employees who need only so much information to decide on their role in the project.

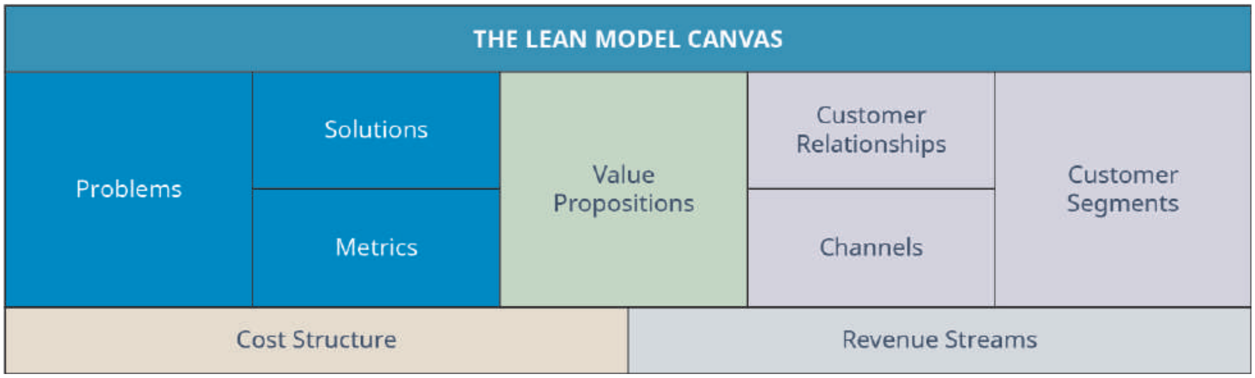

Figure 10.13 The founders of a business create a lean plan to help them set expectations and goals. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Developing a Lean Plan

As mentioned earlier, a lean plan uses lean methodology. This type of planning begins by drafting a short living set of lists to guide you, meaning you can update it as you go.[67] The plan shouldn't take months to develop; you can set it up in a few days. The plan focuses on the business core, so only important details about marketing, the business model, finances, the build-measure-learn loop, and the MVP are added to it.[68]

The following is a list of basic procedures and details to include in a lean plan.

1. Write a short and simple document.
2. Test your MVP through the build-measure-learn loop.
3. Review your results.
4. Revise your plan.

Once these steps are complete, the entrepreneur can start or continue the venture.

Write a Short and Simple Document

This plan does not need to include an executive summary, a company background, or team information. It is literally a short pitch that you can use to share with investors and potential partners. Focus on what is important and include the following:

- Basic strategies for product, price, place, promotion; add people, physical environment, and process if it is a service
- Basic strategies for target market and positioning
- Day-to-day tactics, which include specific tasks or actions that will get an objective done
- A schedule with dates for acquiring needed licenses, launch date, and when to review and revise the plan
- A business model that details how you will make money
- A basic forecast of sales, costs, profit, and break-even analysis

This plan is just a bare bones list of things that need to get done and by whom. It also includes a timeline, a cost, and a reward. It is less like a traditional document and more a series of lists and bullet points. In this case, the entrepreneur is only writing down the essentials of the business to achieve the goal at hand. Later on, when a document is needed for outside stakeholders or bank loans, then a full plan can be developed with

67 Tim Berry. "Business Planning for the 'Lean Startup.' " *Entrepreneur*. September 22, 2010. https://www.entrepreneur.com/article/217343
68 Noah Parsons. "An Introduction to Lean Planning." *LivePlan*. July 13, 2017. https://www.liveplan.com/blog/2017/07/an-introduction-to-lean-planning/

research and details about the market, the environment, trends, and strategies that are more fleshed out.

For example, an entrepreneur who is just opening a prosthetics company can start a lean plan by describing its main product, which can focus on creating custom prosthetics for children. Then it can add a basic price or range of prices for its basic product since it's a custom product, and it will probably vary in price from customer to customer. Another strategy to keep in the plan is where to conduct the business. A central location would probably be a good idea, especially close to doctors and hospitals. Finally, basic promotional strategies used in reaching out to this market, which can include speaking to children's hospitals and local doctors who can refer the patients to the company, can also be listed. In addition, the entrepreneur may decide to create a basic website, online ads, and simple brochures to give information to potential customers. Once all the strategies are laid out, then the timelines can be added from the inception until the launch date, which includes assignments for everyone who will be in charge of the activities in this new business. These can include an office manager, the prosthetist, and a marketer.

Next, the entrepreneur may detail how the money will be made. Will the new business charge the client directly for the product? How about accepting insurance and copayments? These are questions that need to be written down. Then a basic forecast of the market demand will help forecast sales, expenses, and profit.

Test Your MVP through the Build-Measure-Learn Loop

Once the lean plan has been put into place, the next step is to execute it and test the MVP through the build-measure-learn loop. Here is where the rubber will meet the road, and all the assumptions that were made in the plan will be tested in real life.

- Build your MVP.
- Test your idea by sharing it with potential customers.
- Measure results by talking to customers and recording feedback.
- Ask questions such as: Are we building a product people want? What benefits do we need to add? Is this our target market?
- Test different versions and cohorts of users.

In our example, the entrepreneur will have a chance to build the prosthetics and ask questions that will help create a better product over time. At this time, the entrepreneur might find out that the product can be expanded to include orthotics and not just prosthetics, and perhaps that adults can also be included in the market.

Review Your Results

This step should be done at least once a month, where customer feedback, marketing, and outcomes are thoroughly reviewed. This is a great opportunity for the entrepreneur to assess if goals have been met and identify areas for improvement. However, many times, you will encounter that reviewing results can stir resistance from employees (if there are any), as they may become tired of planning, having meetings about planning, and demonstrating results. The reviewing process can inspire some fear or negative feelings over concerns of being blamed, but as a leader, you must always assure them that this process helps them get better at what they do and gives them the information and tools necessary to make the changes that will steer the business onto a more successful path. This is about managing the results and not being deterred by them.

- Review customer feedback and go back to your plan to compare.
- Review target market, 7Ps of marketing, features, and benefits.

- Review numbers or outcomes, which may include sales, profit, customer signups, and even customer reactions to advertisements and product attributes.

In our example, if the prosthetics business is not bringing in enough customers to sustain it, then this is the opportunity to see where issues exist so changes can be made to the lean plan.

ARE YOU READY?

A Lean Scooter Plan

You are interested in opening a new electric scooter business in your small city, as there is no competition. You would like to enable your small town to have smart mobility that is environmentally conscious while reducing dependence on regular transportation such as buses and vehicles.

- Create a lean plan that details how you plan to start your business.

Revise the Plan

Make changes to the plan as needed. Once metrics have been measured against results, marketing is tested and measured, and customer feedback is received, then it is time to revise the plan and make adjustments. This can take the form of adding a feature to the product, adding new products, changing promotional tactics, or communicating differently with customers and consultants.

If there aren't enough customers to sustain the prosthetic business, here is where the founders can make changes to correct course. It may be that customers are not aware of the business, or there aren't enough pediatric customers and perhaps adults can be added to the target market. Once the plan is revised and the resulting changes are made, the business can continue and the process of testing restarts. As you can see in Figure 10.14, this is a continuous process. It requires constant updating and cooperation from everyone involved in the business. Once the process is set up, then it is easier to maintain it and see it as necessary within the business that helps it grow.

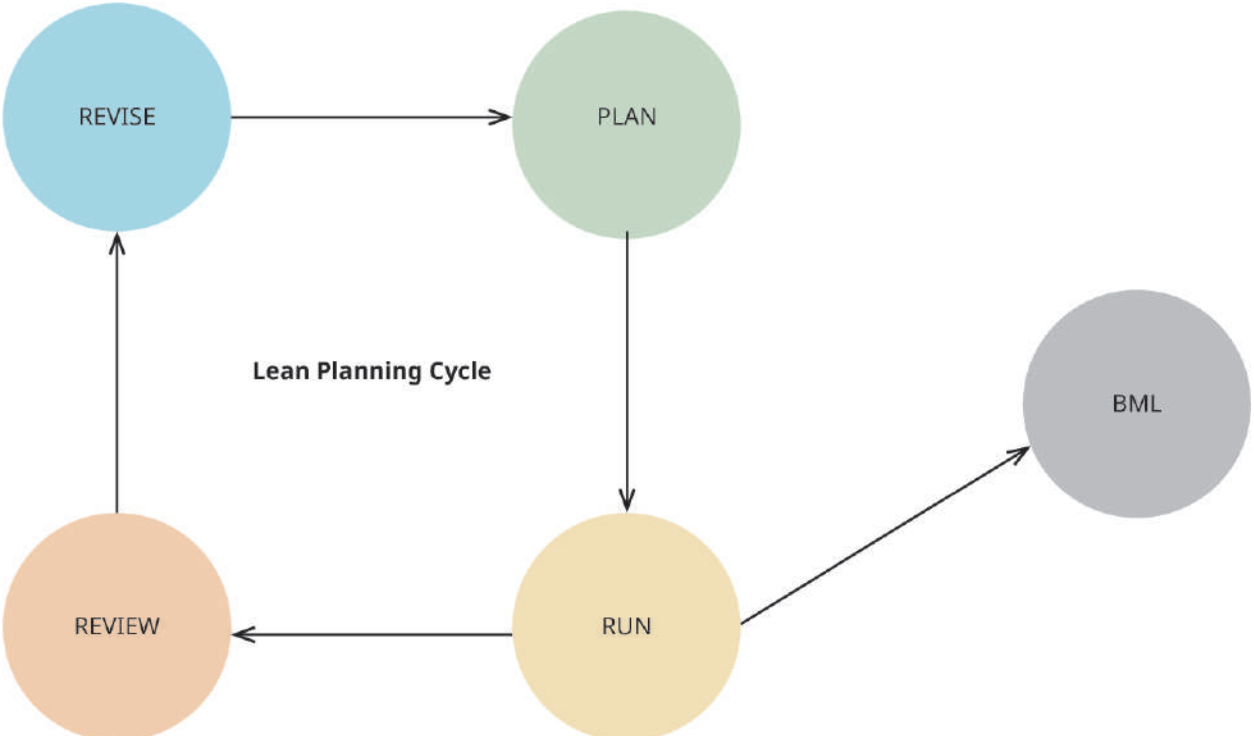

Figure 10.14 The lean plan cycle for small businesses. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Tim Berry—entrepreneur, former Apple employee, writer, and now a lean startup guru—advises businesses on the art of lean planning, as he does not like long planning himself and has little patience for extensive plans and coding. For Berry, lean planning does not contain elaborate information and details that are unnecessary for the business to run. It is not a document per se, but an assortment of short bullet points, some lists, and tables. For Berry, the most important steps to lean planning are to have the following:

1. A lean strategy or plan in place
2. Execution of the plan (or run it like in the Figure 10.14)
3. Review of the results and check against milestones
4. Revision of the plan—change what didn't work and start the whole process again[69]

ARE YOU READY?

Developing a Lean Plan

A local entrepreneur owns a print shop that has been in business for 20 years. The owner focuses mainly on printing business cards, flyers, posters, brochures, and banners for local businesses. He has noticed that his sales have been declining for the past five years because promotions have been evolving into digital ads, social media, and other Internet marketing techniques rather than printed material. He will

69 Tim Berry. "Lean Business Planning Guide." *Lean Business Planning*. https://leanplan.com/

need to innovate if he wants to stay in business.

Last week, he came to see one of your entrepreneurship professors to ask for a student or someone to help him. Since you aced the class, your professor thinks that you can show him how to develop a lean plan, and he offers you an internship. You accept gladly and begin to work on the project.

- Develop a lean plan and explain to the owner how this can help him grow in the next three years.

10.5 Growth: Signs, Pains, and Cautions

Learning Objectives

By the end of this section, you will be able to:

- Determine the lifecycle of a business
- Identify strategies to manage the main needs of each lifecycle stage
- Explain how businesses grow and adapt to changes in their cycles

The work of the entrepreneur is not over after the launch of a business. There are constant changes to manage. Sustained business growth requires a company to improve profits by increasing its revenue, cutting costs, or both. Increasing profit yearly indicates improvement and helps secure financing from banks, attract and reward investors, support opportunities for opening new business locations, and helps reinvest those profits in research and development. As a business matures and stabilizes, so do its revenues and profits, sometimes holding the company stagnant if changes aren’t made.

At the beginning of your startup, everything is new, exciting, and sometimes (or seems) less complex than it will be as the venture grows. Perhaps you have one or two employees, and you manage the operation’s day-to-day activities. Managing the business is still within your power, and the structure of the business is fairly straightforward. Once the business takes off and encounters the challenges of development, such as hiring more employees to keep up with demand, adding new products, or expanding to new locations, you will need more resources and a different strategic approach to managing the business. You must be aware of these changes and steer the business in the right direction to continue its growth. As you begin to understand the signs of growth, you can correctly assess the challenge and come up with solutions. Going through these changes is what is called the **business lifecycle**, a process of five basic stages: starting a business, growth (expansion to new markets and products), maturity, decline, and death or rebirth, as Figure 10.15, shows.

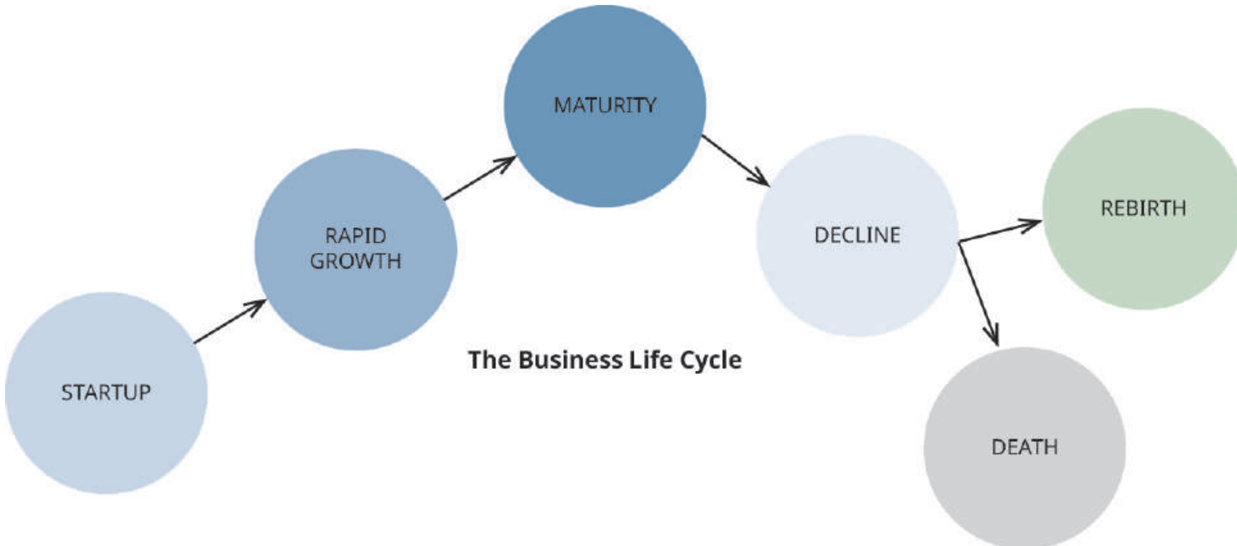

Figure 10.15 Businesses go through cycles of birth, growth, maturity, decline, and rebirth or death. Knowing the cycle of your business and industry will help you to take the steps in the right direction. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Lifecycle Stages

As companies reach new lifecycle stages, owners need to be on the lookout for change indicators. These may include rapid (growth stage), leveled (maturity stage), or diminishing (decline stage) sales. Or they may include the inability to keep up with demand without investing in capital, equipment, software, or technology. Other signs may be a need to increase staff and hire top- or mid-level managers to oversee an expanding workforce, or the need to grow by updating the product, introducing new products, or adding new markets.

Startup/Birth Stage

This stage centers around acquiring the first batch of customers. Entrepreneurs are focused on being able to actually provide and deliver the product, grow their customer base, and have enough cash flow to keep up with demand. The major concern is to survive by at least breaking even. This stage is simple in terms of ownership because there are usually only a few employees, if any. The processes are often informal, and technology and systems can be minimal. The owner usually wears many hats to launch the operation.

For example, an advertising agency might start operations with the co-founders and perhaps one or two employees who work as art designers and/or account executives. At the beginning, the point is to gain clients and deliver the services and products promised—such as TV ads, radio commercials, print ads, or digital ads—while consulting and managing client accounts. The goal is to gain client trust and make sure clients are paying for the services rendered so the agency can pay its employees and vendors. Breaking even is the most basic goal, which means that costs are at least covered, but no profits are seen just yet. Many times, the owner or owners of the company will not take a paycheck for many months, sometimes years, to ensure the business takes off.

Growth Stage

The growth stage, when sales rise due to higher demand, is full of change. There are increases in sales, profits, additional market/product penetration, and an expansion of professional staff. There is usually an increase in cash coming in and going out. A key factor in this phase is to avoid cash strain by paying close attention to costs and ensuring the payment from customers of product and services provided by looking at running reports on costs and sales daily, weekly, and/or monthly. At this stage, systems such as databases and software systems that help keep track of customers and sales, as well as formal processes, need to be put in place for marketing, technology, production, and human resources. Owners must also decide whether to continue with current strategies, sell, or perhaps merge with another company to continue growing. The owner will usually hire managers with experience to take the company to the next level. At this time, owners may need to take out loans and use equity power or shares of the company as capital to leverage further growth. The chapter on Entrepreneurial Finance and Accounting discusses these strategies in more detail.

At this point in our advertising agency example, there are more clients being served; the company is expanding as it adds new clients to the roster and hires more employees to keep up with demand. Revenue is higher, but costs are increasing as well. Processes need to be put into place so employees know what their tasks are and how to do them. Software that handles operations, such as accounting and project management, are put into place because the number of people and processes are increasing. Sometimes, the growth is so unprecedented that perhaps a merger with another company is necessary to be able to provide all the services that clients need.

Maturity Stage

As the business continues, it could enter maturity, which means it has grown to the point where revenues and profits level off. There is adequate staff and more management engaged in maintaining operations. Systems are well developed in all departments and working efficiently, with larger financials and management. The key to remaining active and spurring new life into the business is to remain flexible and continue being a creative and entrepreneurial company. Apple offers a great example of a company that, although its size and power have grown tremendously, continues to innovate as if it were a small company. Other companies such as GE and Procter & Gamble, although they are big corporations with many resources, are now mature and well balanced because they have been in business for a long time. However, they too must continue to innovate and shift with trends, and this is where the lean startup methodology fits well in both small and large businesses because it allows them to be creative and entrepreneurial, regardless of size.

Decline Stage

At this stage, as industries change or business owners fail to keep their offerings relevant, decline is imminent. Sales wane, and a rebirth or death of the business can be expected.

For example, Sears, Payless, Victoria’s Secret, and JCPenney have recently been hit by the new technological and fashion trends that are affecting brick-and-mortar retailers. The way customers shop has been shifting from spending time browsing and shopping in a physical store to adopting new technology to shop from computers and mobile devices. Today, Amazon and other online retailers have developed strategic ways to help customers shop for items they want at an affordable price from the comfort of their devices. Retailers must come up with new, experiential ways to engage the consumer. Interestingly, companies such as GoPro and Fitbit are also struggling with declining sales due to competition, lower demand for cameras, and pricing. GoPro and Fitbit are still good brands that can benefit from a buyout from a bigger company, so they could have a rebirth.

Rebirth or Death Stage

When there are big changes in the decline stage that the company doesn’t evolve to meet, or the business owner doesn’t retain passion, focus, or ability for the venture, the business will end. Blockbuster failed to embrace the new era of video streaming and closed its stores in 2013. Similarly, small retailers, restaurants, tech companies, and manufacturers that fail to innovate cannot sustain a business and usually dissolve.

That is not to say that a rebirth is not possible. If a business innovates and changes to embrace new technology and ideas, it may restart the lifecycle. Polaroid, a pioneer in the instant camera market, saw its demise in the 2000s when the photography industry started to shift toward digital products. The company went bankrupt in 2001 and was sold to several holding companies (controlling companies that buy a stake in the business but don’t operate the business), which licensed the name Polaroid to various electronics manufacturers. Recently, the company entered into an agreement with a holding company that specializes in brand resurrection to develop photography products. These products include a new instant camera and the Polaroid Swing app that allows people to create moving GIF photographs, which are several pictures rotated in a way that show movements and resemble very short videos.[70] Most recently, Polaroid has launched the camera OneStep+, which connects the camera to the phone through an app, allowing the photographer to use different filters and shoot and print instantaneously.[71] This camera, along with other lines of Polaroid instant cameras, have helped resurrect the brand.

The Pain of Growth

Expanding a business usually entails some growing pains. Professional stressors can include figuring out how to serve the customer in the best way possible, produce the right product, create a great brand, sell the right amount, manage cash, delegate tasks to others, and ensure the right people and systems are in place. And of course there are the personal stressors of managing a healthy work/life balance and meeting the demands of the venture.

In 2011, Jessica Thompson, owner of Johnson Security in New York City, felt the strains of growth. She had expanded from sixty to seventy employees and expected to hire ten to twenty more that year. News of her unprecedented business growth had catapulted Johnson Security into higher sales, thanks to better assessment of prospects (potential customers) and better written contracts, but it also heightened her concerns. She had to hire more people. She had to create the infrastructure needed to support the new positions. She had to make sure her liability costs were based on estimates of working hours, because if the number of employees grew, so did her costs. Her visible and public success also made her a target of the New York State Department of Labor, which audited the company to make sure she had classified her workers correctly as W-2 workers instead of as contractors. The audit results were fine and her growth proved organic, but the stress was something she had to go through to succeed as a business owner.[72]

Victor Clark of Clarke Inc., a consulting company, also knows a little about the pain of growth. When asked about his experience as a business owner, Clark said, “My biggest lesson would be ‘profit is an opinion, cash is a fact.’” He says that he struggled many times with cash flow because he disregarded his checking account and because of late receivables. His advice is to pay attention to the checking account, never do a job that makes you lose money, know your costs, and review your numbers every single month.[73]

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70 Brian Mastroianni. “Polaroid Swing App Brings Moving Photos to Life.” *CBS News*. July 27, 2016. https://www.cbsnews.com/news/polaroid-swing-moving-photos-smartphone-app/

71 “Meet the Polaroid OneStep+.” Polaroid. n.d. https://www.polaroid.com/onestep-plus

72 Adrianna Gardella. “Growing Pains at a Growing Business.” *New York Times*. November 3, 2011. https://boss.blogs.nytimes.com/2011/11/03/growing-pains-at-growing-businesses/

73 Andrea Lotz. “5 Entrepreneurs Share Their Business Growing Pains.” *AllProWebTools*. October 9, 2015. https://www.allprowebtools.com/5-Entrepreneurs-Share-their-Business-Growing-Pains/

Strategies for Growth

What are some strategies for growth? Growth can mean increases in revenue and profits, and decreasing expenses. Here are various strategies that can help expand a business whether they are young or established companies.

Product Improvement

An inexpensive and easy way to increase sales of a new product can be done by enhancing a product. This can be in the form of updating the design, making it more durable, changing its size, adding a new feature, or increasing its quality. It is easier to enhance a product than to completely start from scratch.

Take appliances, for example. Rather than creating a new machine to wash clothes, Samsung continually adds features to its washing machines. Recently, the company changed its technology to high-efficiency (HE) technology to save water and energy, and included a separate feature that helps wash items by hand.

Usually, creative fragrance and perfume manufacturing companies can easily adjust their current fragrances by adding a new ingredient or scent instead of developing an entirely new fragrance. Artisanal perfume startups such as Phlur and Pinrose have recently developed their own lines of perfumes that are environmentally conscious, not tested on animals, and good for the body. Some of their perfumes now have new versions of their signature perfumes. In addition to improving their products, they also created new ones out of their original scents by adding them to body sprays, lotions, lip shimmer, and candles that smell exactly like the original.

LINK TO LEARNING

Read this Forbes article on Phlur perfume (https://openstax.org/l/52ForbesPhlur) and see how Phlur sold thousands of bottles of its perfume before customers could smell it.

Market Penetration

Market penetration entails selling more to current customers by showcasing new uses for an existing product. This is the least costly way to attract more customers from within the market. A great example is the versatility of the common pantry staple you see in Figure 10.16, baking soda. Until the 1920s, baking soda was used only as a leavening agent for baking. The mid-century emergence of convenience foods, including premade baked goods, meant a decrease in demand for the product as people baked less at home. To boost sales, Arm & Hammer explored its other uses and began to sell it as a deodorizer, detergent, remedy for heartburn, and as an additive to other products such as detergents, toothpaste, and cleansers.[74]

74 “A History of Innovation: Our Timeline.” *Arm & Hammer*. n.d. https://www.armandhammer.com/en-ca/about-us

Figure 10.16 Arm & Hammer penetrated the baking soda market by expanding uses for the product. (credit: modification of “Baking Soda Box White Powder” by “evita-ochel”/Pixabay, CC0)

New Distribution Channels

Adding new distribution channels gives current customers more ways to purchase the product. For instance, the Internet has provided opportunities for companies to expand their reach by selling items online. Consider a bakery that, in addition to distributing its cookies in its store and through retailers, adds an online store. While a large number of companies have websites and apps that can sell directly to customers, entrepreneurs who don’t want or have an e-commerce function on their site can use portals such as Etsy, Amazon, and Ebay. A jewelry maker, for instance, can sell his or her items through one of these websites without having to pay someone to create or manage a website for her business. Other more conventional ways of using different distribution systems include making products available in retail stores, kiosks, or grocery stores. Take for instance California Pizza Kitchen. It originally existed solely as a restaurant chain but now has created frozen pizzas that we can purchase at the grocery store.

Product Line Extension

A business can extend its product line to appeal to different customers with different needs and budgets. It can start with a basic, no-frills product for the low-end consumer. Then, it can provide a higher quality, higher-price product with a few more features. A step higher would be a high-end product that is more luxurious or has additional benefits and capabilities that are higher priced. This strategy is often used with cameras, software, vehicles, and hotels. Tech companies will have their basic products and will increase their gadgets’ quality and benefits to make them more luxurious and capture different markets along the way. Uber, for example, offers its basic riding service to everyone who requests a ride. Drivers can pick them up in any type of vehicle they own. An upgrade to this service is the new Uber Black service, which gives the customer the ability to request a luxury car or SUV. These vehicles must be newer than five years old, and they must be in excellent condition. This service is more expensive than regular rides, costing three or four times more than a ride in a regular vehicle.

Adding New Markets

Developing new markets is a riskier path to growth. A company that was catering to only local customers might open a second location in another town or region, or provide products online to reach distant clients in other cities, states, or countries.

Fast fashion companies have been at the forefront of this trend. These are retailers that design, manufacture, and distribute the product to customers quickly and cheaply by skipping the regular four seasons of the fashion year. Instead, they usually offer new designs every two or three weeks, and entice shoppers to purchase clothing at a faster rate. Retailer store Zara, (pictured in Figure 10.17), the fast fashion company from Spain, has seen unprecedented growth through expansion to other markets, for example.

Figure 10.17 Fast fashion company Zara has been successful at developing new markets. (credit: modification of "Zara 222 Broadway" by "Lollasp"/Wikimedia Commons, CC0)

Born Global Companies

As mentioned earlier, entering global markets is a common method of expanding a business. Some companies will turn to global expansion during a growth or mature cycle, and some companies will seek global markets from the start, as **born global** companies do. A born global company is one that has as its goal to serve the world with its products. Companies that have new products that have never been created before—today mostly technological and medical products—usually benefit from this kind of strategy. Other entertainment and consumer products can be thought of as global as well, especially when it's a new product category.

Red Bull is an example of a born global company that had its eyes set on the global stage, even before it started growing, because it had a new product that no other company had ever created. After Red Bull came up with its products, other companies followed suit, and a new product category of energy drinks was born. So far, the company has been around for 31 years, has more than 12,000 employees in 171 countries, and has sold more than 75 billion cans around the world.[75] The success that this born global company has experienced can be attributed to its grassroots marketing approach on college campuses, the sponsoring of events (Figure 10.18 shows two examples), as well as a massive distribution approach that targets young

75 "Company." *Red Bull*. n.d. https://www.redbull.com/us-en/energydrink/company-profile

people, extreme sports athletes, and professionals who need an energy boost.

(a) (b)

Figure 10.18 Red Bull owes its success to its promotional efforts across the globe. The company has found success (a) targeting consumers interested in extreme sports, such as these spectators attending a cliff diving event in Massachusetts, and in sponsoring events like this (b) Motocross competition. (credit (a): modification of work by "{enry"/Flickr, CC BY 2.0; credit (b): modification of work by "GO Visual"/Flickr, CC BY 2.0)

LINK TO LEARNING

In its efforts to be a global company, Red Bull sponsors many events. In 2012 Red Bull sponsored Stratos, the highest jump (https://openstax.org/l/52RBStratos) ever recorded by a person from space, in a "beyond global" event. They also sponsored the "Can You Make It?" 2018 competition (https://openstax.org/l/52RBCanMakeIt) in which teams of students traveled across Europe to Amsterdam in a week using only Red Bull as currency.

Licensing, Franchising, Joint Ventures, Mergers, and Acquisitions

Other riskier ways to grow include the integration of outside ventures through licensing, mergers and acquisitions, joint ventures, and strategic alliances.

Licensing is a contract in which one enterprise gives permission to another entity to manufacture and sell its products for a royalty, which is a payment in exchange for the use of property or an asset, whether intellectual or physical that can be used to generate revenue. Some of the property that can be licensed can be in the form of a design, a copyright, an invention, a patent, or formula.[76] Instead of investing directly in manufacturing and marketing additional items, many companies such as Disney, Mattel, NBA, and Warner Brothers lend their characters and copyrights to other companies to use on their merchandise. They then receive a royalty payment for their license.

76 "Licensing." *Entrepreneur* n.d. https://www.entrepreneur.com/encyclopedia/licensing

Licensing can also occur in reverse: Small companies with a technology, medical solution, software, or product that cannot be manufactured by them can seek other companies to which they can license their intellectual property. The smaller company can also license from another company and create the product or service because that is its core competency.

Franchising is a form of licensing that allows the business (franchisor) to share its business model to expand the business through various distributors (franchisees) for a fee. In turn, the franchisor provides the training, marketing, know-how, management, and support to help the franchisee fulfill its sales objectives. Franchising is common in industries such as restaurants, automotive, hotel, cleaning, and home services, to name a few. Popularly known franchises are fast-food restaurants, such as Chick-Fil-A or McDonald’s, which have quickly expanded in the US—and around the world in the case of McDonald’s. Smaller local and national franchises include Fit4Mom, Mosquito Squad, Chocolate Factory, and Soccer Shots.

A **joint venture** is the creation of a new business in which two different enterprises share the expenses and profit to achieve certain goals of a project. This approach reduces the risk of investing directly in capital equipment, and it also allows them to share each other’s knowledge and expertise. You can see this done with small businesses that collaborate to save money and help each other out.

Larger companies do this as well to leverage a particular advantage and reduce risks and costs.[77] Google and NASA joined efforts to bring NASA’s information about the weather, locations, and forecasting to the fingertips of people via a Google search. This joint venture proved fruitful, as they continue to collaborate on various projects including robotics and space exploration.[78]

In **mergers and acquisitions**, two companies combine or one buys the majority stake of the other. The goal is to enhance profitability and reduce their risk by diversifying their portfolios, combining resources such as boards of directors, combining efforts to achieve efficiency (for example, being able to increase production and thereby reduce production costs), broadening market access, sharing technology, and increasing access to capital. Usually, mergers and acquisitions are conducted by larger companies such as Dow Chemical and DuPont, Anheuser-Busch InBev and SAB Miller, Heinz and Kraft, and CVS and Aetna, but smaller companies can also benefit if they both have an opportunity for synergy.

Strategic alliances are arrangements that two or more entities create to work on a project by sharing some of their strengths and resources, but not actually creating a new entity like in the case of a joint venture. In this alliance, both entities are still considered independent and only pool their resources to work on a specific project because it may be faster and more cost effective to work together. Both companies’ assets remain separate.[79] An example of this is Star Alliance, a strategic distribution alliance between many airlines such as United Airlines, Lufthansa, Air New Zealand, Turkish Airlines, Croatia Airlines, and 22 additional airlines, to connect customers all over the world through a shared booking system.[80]

Pros and Cons of Growth Strategies

Each growth opportunity has pros and cons, which are outlined in Table 10.6.

77 “Joint Ventures.” *Inc.* n.d. https://www.inc.com/encyclopedia/joint-ventures.html
78 “Google Moves into NASA’s Space.” *Financial Times*. November 10, 2014.
79 Will Kenton. “Strategic Alliance.” *Investopedia*. September 5, 2019. https://www.investopedia.com/terms/s/strategicalliance.asp
80 “Proud Member of Star Alliance.” *United*. n.d. https://www.united.com/web/en-US/content/company/alliance/star.aspx

Pros and Cons of Growth Strategies

Strategy	Pros	Cons
Product improvement	Improving performance, quality, and cost of product; can also add to sales and profits	Fails to deliver a benefit; can turn out to be a lost investment
New product development	Staying ahead of the competition, increasing sales/profit, going into new markets	Create products no one wants, make costly mistakes
Market penetration	Increase sales by adding new benefits to existing products	Mispositioning the product, which will miss communicating to the right market or by communicating benefits the target doesn't care for
New distribution channels	Reaching target market multiple times or reaching them at least once	More channels to keep track of and to manage
Product line extension	Cater to different markets and different budgets; educate consumers to want better, more expensive products	Fails to differentiate between products, cannibalization (decrease in sales due to introduction of new product by same company)
Adding new markets	Expanding customer reach, adding to sales and profit	More customers to take care of, not engaging them correctly
Seek global markets	Serve global markets, reach more customers, increase sales and profits	Dealing with more customers, mistakes in many areas could happen
Integration of businesses	Add new capabilities, synergy, take on more projects	Losing investment, losing project, not getting along well, breaking up

Table 10.6

Key Terms

born global venture seeking to be a global company from its inception
build-measure-learn loop step-by-step approach on how to maneuver a startup, how to change course if necessary, how to persevere, and how to accelerate the expansion of a business
business failure ending a business due to the lack of goal attainment, which can include low levels of revenue and profit, or not meeting investors' expectations
business lifecycle stages companies go through: birth, growth (or expansion to new markets and products), maturity, decline, death or rebirth
early adopters people who like to try new things and can be found at the onset of the adoption process for a product
franchising form of licensing that allows the business (franchisor) to share its business model to expand through various distributors (franchisees) for a fee
Global Entrepreneurship Monitor (GEM) organization that researches entrepreneurship around the world
innovation accounting assesses whether the changes made to the product are creating the desired results
iterations small changes to the current version of a product to make it better fit consumer needs
joint venture temporary partnership in which two different enterprises combine for the purpose of mutual benefits such as sharing of expenses and to work toward shared goals and the associated potential revenue
lean pitch verbal delivery of an idea or business plan as a request to a group of investors by an entrepreneur
lean plan brief business plan shown to potential investors and employees that is a fast and effective way to set, manage, and evaluate goals and strategies in a business
lean startup methodology entrepreneurs use this method to help them innovate by continuously testing their products and getting feedback from customers in real time
licensing contract in which one enterprise gives permission to another entity to manufacture and sell its products for a royalty
mergers and acquisitions when two companies combine, or one buys the majority stake of the other
minimum viable product (MVP) early version or prototype of a product that may not be polished or complete but that functions well enough that you can begin to market it or test it with potential users
pivoting crucial change done to test a hypothesis regarding the basic product, its growth potential, and business model; if something is not working, then a change or a "pivot" needs to take place
strategic alliance arrangement created by two entities to work on a project by sharing some of their strengths and resources, but not actually creating a new entity as in the case of a joint venture

Summary

10.1 Launching the Imperfect Business: Lean Startup

There is no such thing as launching a perfect business. A startup requires time to clarify its identity, market, product, and business model through the build-measure-learn loop, which requires businesses to describe or *build* a prototype of a product, ask for feedback from potential and actual early customers, *measure* their responses, and *learn* from that feedback and make changes to improve the product to something customers want. Older companies usually have a more stable and developed set of strategies because they have been in business for a while, but even they have opportunities to innovate and grow. The lean startup method provides an opportunity for companies to approach management in a measurable and provable way. Customer feedback allows the companies to make iterations and pivots that are necessary to get back on the right track. Pitching to investors can yield better results when using the lean approach, because investors like to see experience-gained data. The lean startup method is a tested way for new and old companies to stay in business and operate, even when there is a lot of uncertainty.

10.2 Why Early Failure Can Lead to Success Later

Failure is common in business creation, especially in the early stages. Only a small percentage of ventures make it to the two-, five-, and ten-year mark. Common reasons for this include mistakes and missed opportunities in marketing, financing, management, and innovation. However, there are steps the owner can take, such as making sure they are targeting the right customer, ensuring proper finances are in place to operate and grow the business, creating contracts when sharing the business with stakeholders, and innovating when needed. Fear of failure is also a major contributor to business failure. Some suggestions to manage fear include adjusting expectations and asking for help.

10.3 The Challenging Truth about Business Ownership

Entrepreneurs operate in an extremely competitive landscape. This space has positives and negatives, including being autonomous, being able to expand one’s own ideas, and schedule flexibility. Serving people and employees well can be very satisfying as can the financial success of a strong profit. On the negative side, resolving constantly arising challenges, wearing many hats, dealing with challenges and issues, and having adequate time and cash flow can make entrepreneurship difficult. Women and minority entrepreneurs face additional challenges that can make the experience of being an entrepreneur much more difficult. These include lack of funding opportunities, lack of business education, not being taken seriously, lack of mentorship, and lack of resources. However, there are several organizations that provide the guidance and connections targeted to these groups.

10.4 Managing, Following, and Adjusting the Initial Plan

Having a lean plan is helpful in setting up expectations and measurements. This is a living document, so its creation and updating are a process. The process starts with building a short document that outlines the basics of product, market, and strategies, with a short schedule of tasks. After a trial run, where the prototype or actual product is tested with customers, the plan is reviewed and revised to incorporate the feedback.

10.5 Growth: Signs, Pains, and Cautions

A company goes through a lifecycle of birth, growth, maturity, decline, and death or rebirth. At each of these stages, there are opportunities and choices to make based on the owner’s personal and business goals. Business growth requires the owner to innovate through various means to survive and to thrive. These strategies are meant to increase sales, cut costs, or a little of both. Some of these strategies include making changes to the product, adding new products and markets, adding new channels, and acquiring other companies.

Review Questions

1. What is pivoting?

2. How is pitching different in the lean startup method?

3. What is the lean startup process?

4. What are some examples of an MVP?

5. What is the success rate of businesses in the first two to ten years of life in the United States?

6. How can an entrepreneur learn from failures?

7. Which gender experiences more fear about opening a business? Why do you think it they are more fearful?

8. What are some of the realities of business ownership?

9. How can entrepreneurs deal with these negative realities?

10. What percentage of businesses last five years or more?

11. What percentage of US businesses are minority owned?

12. What is a lean plan and what are its components?

13. What are some of the items or sections that do not have to be included in a lean plan?

14. What kind of lifecycles do businesses go through? Why?

15. How does each phase affect business decisions?

Discussion Questions

1. Find an example of a video of a lean pitch online. What, in your opinion, makes it successful?

2. Find a company that has made a pivot and explain why the pivot worked.

3. If you were starting a business and had to create an MVP, what would that MVP be?

4. Are there any downsides to the lean startup method? If so, what might they be and what sorts of products or companies might fall prey to them?

5. If you were conducting a lean pitch to investors, which steps of the pitch would you find most difficult and why?

6. Discuss how you could identify and manage your fears as you start your own business.

7. What strategies do you think can help women overcome their fear of failure? Relate your answers, if applicable, to a woman you know who has such fear and describe strategies she uses to overcome it.

8. Discuss how minorities and women can use resources and strategies to deal with their additional challenges as entrepreneurs.

9. Pick three cons of business ownership and strategize how to turn them into pros.

10. Now choose three of the pros of business ownership and consider whether any of them could be cons in certain situations.

11. Discuss how a lean plan allows you the flexibility to change course if something is not working for your business.

12. Discuss the differences between making changes to a product for growth and creating a new product from scratch.

Case Questions

1. A friend recently heard that you won a pitching competition and she would like you to help her with her business pitch to investors. She started a company called “Fit for You,” a prosthetics company for children and adults that is using the latest materials and technology to help people live better lives. She has been in business for a year, and she uses lean methodology to innovate and create better products, but she needs capital to buy additional equipment to meet demand. She has determined that investors would be the best funding source for her needs. What should she focus on in a five-minute lean pitch to investors to secure the $120,000 for additional equipment?

2. One of your friends has recently opened a 24-hour gym for women ages 18–45. She is excited about the opening but wants to ensure that she is providing the right services to her customers and is wondering whether she did enough research up front to really figure it out. She comes to you for advice. What would you tell her?

3. Take a look at the GEM page http://www.gemconsortium.org/country-profiles and click on the US link. Determine how the United States ranks in several measures on its profile. How does its entrepreneurial ecosystem compare to that of another country, such as Mexico or Canada?

4. Your best friend is a kindergarten teacher who has decided to open a new learning center where toddlers and young children can play in an interactive environment to enhance their motor skills, cognitive development, and leadership skills. She is very excited about her new entrepreneurial experience, but has no idea about the challenges she may face as a young Hispanic woman in her 30s. She knows you have taken an entrepreneurship class before, so she asks for your help in figuring out where to find business resources and recommendations to overcome the challenges she may face. You are happy to help and you answer the following questions:

What kind of overall advice would you give her? What groups and resources do you think she can tap into? What are some of the challenges she may face as a minority? How can she overcome them?

5. You and a team of students from your university are interested in creating a virtual agent (chatbot) that can interact with humans online. You have noticed that small businesses could benefit from adding a chatbot to provide great customer service at all times of the day at a fraction of the cost. Your goal is to create chatbots for a few industries that are very customer-service intensive (realtors, restaurants, doctors’ offices, etc.), and you think you can come up with a product that can be sold to small- or medium-sized businesses. One of your team members who is a computer science major has already starting coding the first program, but you know very well that you will need lean planning to get your ideas down in writing and to pitch it to a few investors. Develop your 7Ps for one of the chatbots in bullet point format and include the target market, the positioning, and the business model that you would use to make money.

6. You and your business partner have been in business for five years selling cellphones and other accessories. Recently, you noticed that the market is quite saturated, and your competition is very high. Your sales have been flat for the last year and a half, and no matter what promotions or cellphones you carry, you can’t seem to improve your sales. You also realize that the industry is mature and it will be difficult to make money unless something drastic changes. What kind of changes do you think you can implement to expand your business?

Suggested Resources

10.1 Launching the Imperfect Business: Lean Startup

Lean startup: http://theleanstartup.com/#principles

Toyota's Way: https://vimeo.com/44328452

14 Management Principles of Toyota: http://www.panview.nl/en/lean-production/toyota-way-j-liker-summary

Innovation accounting video: https://www.inc.com/eric-ries/entrepreneur-eric-ries-innovation-accounting-secret-to-fast-growth.html

10.2 Why Early Failure Can Lead to Success Later

Global Entrepreneurship Monitor: http://www.gemconsortium.org/

10.3 The Challenging Truth about Business Ownership

Asian American Chamber of Commerce: http://www.asian-americanchamber.org/

Black Chamber of Commerce: https://www.nationalbcc.org/

Hispanic Chamber of Commerce: https://ushcc.com/

Ladies Who Launch: https://www.ladieswholaunch.org/

Minority Business Development Agency: https://www.mbda.gov/

National Association of Professional Women: http://womenforhire.com/company/national-association-of-professional-women-napw/

National Association for Women Owners: https://www.nawbo.org/

Small Business Agency: https://www.sba.gov/

The Female Entrepreneur Association: https://femaleentrepreneurassociation.com/

Women's Business Center at SBA: https://www.sba.gov/tools/local-assistance/wbc

Women's Business Enterprise National Council: https://www.wbenc.org/

10.4 Managing, Following, and Adjusting the Initial Plan

Tim Berry's Lean Business Planning Guide: https://leanplan.com/

10.5 Growth: Signs, Pains, and Cautions

International Franchise Association: https://www.franchise.org/

US Small Business Administration Licenses and Permits: https://www.sba.gov/business-guide/launch-your-business/apply-licenses-permits

11 Business Model and Plan

Figure 11.1 The initial plan for Vita Coco did not work for its founders, Michael Kirban and Ira Liran, but the coconut water found later success, ultimately becoming the market leader, by using customer-focused design throughout the entrepreneurial process. (credit: modification of "Vita Coco at Vitality Show" by Zeyus Media/ Flickr, CC BY 2.0)

Chapter Outline

Introduction

Michael Kirban and Ira Liran had no experience in their industry when they launched their business. After a chance encounter with Brazilian women in a bar who mentioned how much they missed having coconut water, Kirban and Liran decided to launch Vita Coco.

The Vita Coco founders promised to deliver a product they had not even created yet, and further, they had no experience in manufacturing, but they launched the business nonetheless in the early 2000s. The initial plan for the business did not work after the US Food and Drug Administration blocked shipments to the United States because they failed to register the business properly. The partners developed the business into a social movement with a specific mission: to make an impact on both their consumers and the people they work with and the communities in which they live. Things ultimately worked out for Kirban and Liran. Vita Coco became the market leader in this niche segment, as they turned their attention to putting customers first. Although customer-focused design is integral to the entrepreneurial planning process, you should avoid launching a venture with the attitude that if you build it, customers will automatically come, because it does not always work that way. There are tools available to entrepreneurs to use to plan their journey to make goals a reality rather than just a wish or a dream.

11.1 Avoiding the “Field of Dreams” Approach

Learning Objectives

By the end of this section, you will be able to:

- Understand the importance of planning
- Understand the concepts of product and service innovation, and define and understand key business models
- Describe and be able to construct a value proposition for a new business idea (product or service)

In the 1989 film *Field of Dreams*, Kevin Costner plays an Iowa farmer who hears a voice that tells him, “If you build it, he will come.” Inspired by this vision, Costner’s character turns his cornfield into a baseball field (of dreams), and eventually the ghosts of deceased baseball players such as Shoeless Joe Jackson appear on the field as younger versions of themselves. The movie coined the popular axiom that “if you build it, they will come,” just as the players appeared after the field of dreams was built. Although it’s a fun saying for film buffs and sports fans, this approach is one you will want to avoid in entrepreneurship. In fact, the entrepreneurial graveyard is littered with ghosts of startups that never gained traction with customers, never to be heard from again. (Seventy-five percent of venture-backed startups fail, according to one recent study.)[1] Thus, you don’t want to blindly build a product and hope that customers will come. Juicero is one recent example of product that conducted little-to-no customer discovery before launch. A cold press juicer made by this San Francisco startup cost $699 at launch. The juicer squeezed packs of cut up fruits and vegetables, but customers found they could just as easily squeeze the juice out of the packs by hand and avoid the hefty price of the juicer.

Customer acquisition and customer retention are not easy processes by any means. You have to work to gain a customer and work even harder to get her to return. One study by the data analysis firm CBInsights of why 101 startups failed found that 42 percent of them joined the “entrepreneurial afterlife” because there was “no market need,” which suggests a customer (or lack thereof) problem.[2] Current trends in entrepreneurial thinking reflect a customer-centric approach: From the start, entrepreneurs infuse their insights into the planning process through a process called “customer discovery.” The entrepreneurial journey should begin with finding what the serial entrepreneur, author, and educator Steve Blank, one of the founders of modern entrepreneurship, calls the problem/solution fit.[3],[4] In a complementary approach, the Mosaic/Netscape founder Marc Andreesen discussed the need to achieve product-market fit.[5] In other words, don’t just build a baseball field and expect players to show up. This is an oversimplification, but if we extend the *Field of Dreams* analogy before blindly believing in the magic, you would want to talk to prospective players and fans to see if a field is needed, what type of field (corn-to-baseball?), why that field is needed, how that field would be used, and what features of the field would be most useful—*before* you go to bat (Figure 11.2).[6]

1 Patrick Henry. “Why Some Startups Succeed (and Why Most Fail).” *Entrepreneur*. February 18, 2017. https://www.entrepreneur.com/article/288769

2 “298 Startup Failure Post-Mortems.” *CBINSIGHTS*. February 28, 2019. https://www.cbinsights.com/research/startup-failure-post-mortem/#original

3 Steve Blank. “Driving Corporate Innovation: Design Thinking vs. Customer Development.” July 30, 2014. https://steveblank.com/2014/07/30/driving-corporate-innovation-design-thinking-customer-development/

4 Hayley Leibson. “How to Achieve Product-Market Fit.” *Forbes*. January 18, 2018. https://www.forbes.com/sites/hayleyleibson/2018/01/18/how-to-achieve-product-market-fit/#10814b68476b

5 Tren Griffin. “12 Things about Product-Market Fit.” *Andreessen Horowitz*. February 18, 2017. https://a16z.com/2017/02/18/12-things-about-product-market-fit/

6 Mike Pinder. “Innovation Reality Check: Are You Building a ‘Field of Dreams’?” *Board of Innovation*. December 31, 2017. https://www.boardofinnovation.com/blog/2017/01/31/innovation-reality-check-are-you-building-a-field-of-dreams/

Figure 11.2 This field in Dyersville, Iowa, was used in the filming of *Field of Dreams*. (credit: "FieldofDreamsMay06" by "JoeyBLS"/Wikimedia Commons, CC BY 2.5)

Business Model

Although there are countless varieties of business models, the *Scaling Lean* author Ash Maurya offers three common types: direct, multisided, and marketplace. Direct businesses are the most common and involve one-sided actors—that is, users—becoming your customers. A coffee shop is a classic example; other examples include retail stores, software as a service (SaaS), many mobile apps, hardware stores, and stores that sell physical goods. In multisided models, users and customers—multi-actors—are usually different people. Ad-based models, big data, and enterprise are common examples where the products are free to users, and their value is monetized by a different customer base. Marketplace models are a more complex variant of multisided models made up of two different customer segments of buyers and sellers. eBay and Airbnb are well-known examples of marketplace models.[7]

Although planning is important, adaptability within the planning process is equally important. That's what the business model approach is all about: outlining an approach but changing that approach throughout if or when you discover that your assumptions and educated guesses were wrong. For each new iteration, or version, the entrepreneur makes a minor change to the current business model to better capitalize on market opportunities.

Successful entrepreneurs are often multidimensional: part dreamer, part pragmatist. Adam Grant, Wharton School of Business professor and author of the best-selling book *Origins: How Non-Conformists Move the World*, explores how entrepreneurs are "capable of recognizing a good idea, speaking up without getting silenced, building a coalition of allies, choosing the right time to act, and managing fear and doubt."[8] *Entrepreneur* magazine tells the story of FedEx founder Fred Smith, who, while attending Yale University in the mid-1960s, wrote an economics term paper on the need for a new approach to overnight delivery in the computer age. His professor, unimpressed with Smith's idea, graded his paper a C because the idea was not feasible.[9] After graduation, using innovative thinking, dogged determination, and hard work, Smith would turn his "unfeasible" concept into the world's first overnight delivery company, and in so doing, change the transportation industry forever. Smith embodied the entrepreneurial concept of being part dreamer, part pragmatist.

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7 Ash Maurya. *Scaling Lean*. New York: Portfolio/Penguin, 2016.
8 "Bio." Adam Grant. n.d. https://www.adamgrant.net/bio
9 "Fred Smith: An Overnight Success." *Entrepreneur*. October 9, 2008. https://www.entrepreneur.com/article/197542

LINK TO LEARNING

Read about the popular corporate narratives related to relatively new companies. Consider whether these stories involve inventor-founders. If so, what is the invention and how does that tie in with the current and future narrative of the company?

Listen to the NPR podcast "How I Built This" with Guy Raz (https://openstax.org/l/52NPRGuyRaz) to hear stories about more than 100 startup companies and their founders.

Several more brief narratives on how to tell your company's story (https://openstax.org/l/52CompanyStory) are also available.

Sports metaphors offer important entrepreneurial lessons beyond insights on customer discovery and planning. In baseball and softball, you must field a team to enter the game. In boxing, you enter the ring alone to go toe to toe with your competitor (where some of the best-laid plans get thrown out after you get hit). The tides of entrepreneurial thinking have shifted from the twentieth-century economist Joseph Schumpeter's early belief that it is "lone individuals who carry novelty" for wider market exploitation and benefit to society to the notion that it takes a team to innovate and back to the idea that individuals can enact entrepreneurial change.[10] "Solopreneurs," for instance, are hard-working entrepreneurs who are comfortable working alone on all the requisite tasks of starting a venture.[11] At the same time, many successful investors preach the merits of teams in entrepreneurship. Venture capitalist Aileen Lee says that people are the second-most important factor behind addressable market when evaluating startups.[12] The cohesion, diversity, and makeup of the team all contribute to investable worthiness and potential entrepreneurial success (Figure 11.3). Many successful accelerator programs have typically required teams in order to be considered for entry into their programs. The accelerator Techstars has said that what they look for in a startup is "team, team and team,"[13] and the accelerator Boomtown requires at least two present founders for the duration of its accelerator program.[14]

10 Joseph A. Schumpeter. *Can Capitalism Survive?* New York: George Allen & Unwin, 1942.
11 John Rampton. "4 Differences Between Solopreneurs and an Entrepreneur Working Alone." *Entrepreneur*. May 15, 2015. https://www.entrepreneur.com/article/245766
12 Aileen Lee. "Investing and Business Lessons from Aileen Lee (Cowboy Ventures)." *25iq*. April 21, 2018. https://25iq.com/2018/04/21/investing-and-business-lessons-from-aileen-lee-cowboy-ventures/
13 Michael Cohn. "Team, Team, Team: Welcome Tyler Scriven to Techstars Atlanta." *Techstars*. April 13, 2016. https://www.techstars.com/content/accelerators/team-team-team-welcome-tyler-scriven-techstars-atlanta/
14 The Farm. "Accelerator FAQs." n.d. https://thefarmatl.com/about/faq/

Figure 11.3 While solopreneurs can certainly find success, many ventures find value in a team approach. (credit: “achievement agreement arms business” by rawpixel/Pixabay, CC0)

Multiple shifts in sources of innovations and rapid business model exploration may reflect high startup failure rates. Lack of planning is also a major reason for failure. Most small businesses fail within the first few years because of cash-flow issues. With more people today willing to field a startup team or enter the entrepreneurial ring, failure is more often than not a part of the entrepreneurial journey. Serial entrepreneurs launch numerous ventures, many of which fail, before moving on to other efforts. Entrepreneurs are the modern-day equivalent of *Hamilton: An American Musical*’s Hercules Mulligan to the world: They get back up again after getting knocked down.

Innovation

One of the fundamental theories of entrepreneurship is that it brings **innovation**, which can be a new addition to the market or a novel change to an existing product or service. The famed management guru Peter Drucker put it simply: “Entrepreneurs innovate.”[15] Of course, we should note that not all entrepreneurial ventures involve innovation. Even for those that do, however, the term *innovation* can be ambiguous. Further complicating the issue, a plethora of different extensions (or “types”) has arisen surrounding the concept of innovations—such as radical, incremental, and disruptive—that have been used to describe and emphasize different innovations in different situations.[16] *Innovation* can also refer to products or processes because there are differences between product innovation and process innovation. In other words, not all innovations are created equal.[17]

As it pertains to entrepreneurship, the creative destruction of old markets with inferior technology and the creation of new markets, as defined by Schumpeter back in the 1930s, occurs through **disruptive innovation**.[18]

15 Peter F. Drucker. *Innovation and Entrepreneurship: Practice and Principles*. (New York: Harper Business, 1985), 30.
16 Henri Simula. “Concept of Innovation Revisited: A Framework for Product Innovation.” *International Association for Management of Technology 2007 Proceedings*. 2007.
17 Salem Baer. “The 3 Types of Innovation: Product, Process, & Business Model.” *Differential*. January 16, 2017. https://differential.com/insights/the3typesofinnovation/
18 Joseph Schumpeter. *Theory of Economy Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle* (Cambridge: Harvard University Press, 1934), 19.

The adjective *disruptive* also became a bit of a catchphrase in the 1990s during the first Internet era, largely due to the popularity of Clayton Christensen's Figure 11.4 theory of incumbent failure in the face of what he first termed "disruptive technology" and later renamed "disruptive innovation."[19]

Figure 11.4 Clayton M. Christensen has contributed many ideas about innovation to the field of entrepreneurship. (credit: "Follow Business of Software - Clayton Christensen" by Betsy Weber/Flickr, CC BY 2.0)

As Christensen defines them, disruptive innovations are often more advantageous to new entrants than to incumbent firms. This is because once market uncertainty occurs as a consequence of the disruption around the disruptive product, established firms consider it irrational to abandon their existing paying customers for the smaller customer base of the new, initially small market for what they believe is inferior technology. New entrants challenge incumbent firms by either creating markets where no markets exist, turning nonconsumers into consumers, or by targeting overlooked segments of the market and later moving up market as the product improves. Leading firms' decision criteria for developing new products and commercializing innovations are all biased toward supporting incremental innovations that build on their existing technology base and help maintain or grow revenue and profitability in established markets. This opens the door for startups to develop and introduce disruptive innovations and profit from them. Table 11.1 lists some disruptive innovations.

19 C. M. Christensen. *The Innovator's Dilemma*: *When New Technologies Cause Great Firms to Fail* (Boston: Harvard Business School Press, 1997). C. M. Christensen, Taddy Hall, Karen Dillon, and David S. Duncan, *Competing Against Luck: The Story of Innovation and Customer Choice* (New York: HarperCollins, 2016).

Disruptive Innovations

Area	Timeframe	Established Market	Disruptive Innovation
Medical imaging	1960s	X-rays	Ultrasound offered a new type of imaging; X-ray companies lost out to the market and could not match the innovation, although eventually they purchased many ultrasound companies
Screens	1990s–2000s	CRT (cathode ray tube)	LED/LCDs innovated to overcome their display limitations, replacing heavy and bulky CRTs. More recent innovations like foldable screens and retinal scans have added more functionality and “intelligence” to link to Internet of Things devices
Entertainment	2000s	Video rental	Streaming services ousted much of the video rental market and companies like Blockbuster found themselves irrelevant in the market. More recently, multiple streaming services along with proprietary content (and “Over the Top” menu options) have disrupted cable TV companies

Table 11.1

ARE YOU READY?

Netflix’s Disruption

Netflix, founded in 1997 in California, disrupted video rental stores such as Blockbuster with its subscription service, which mailed DVDs directly to customers’ homes. The rental stores, whose business model was predicated on revenue from late fees, could not compete with the ease and convenience of home delivery coupled with lower costs than the per-tape rental fees. But as streaming video content directly to televisions or over-the-top devices disrupted Netflix’s original DVD-by-mail model, Netflix moved to offer a streaming service in addition to the DVD by mail model. In both instances, Netflix’s prevailing model was predicated on serving as a distribution outlet for content created by other businesses. Netflix in recent years has begun not only distributing others’ content but creating its own TV and movie content as well. (*Orange Is the New Black* and *The Unbreakable Kimmy Schmidt* are both original Netflix series; *The Irishman* is an original Netflix film.) Now content creators such as Disney and Marvel are creating their own streaming distribution platforms to exclusively deliver their own content, eventually pulling those shows from Netflix.

- What should Netflix do to counter this threat to the third iteration of its business model?
- What threats does the end of net neutrality pose to Netflix’s business model?

- If you were in charge at Netflix, would you pay more to Internet providers to gain faster delivery of your content on the Internet? Why or why not?

In separate but related work, Christensen also developed the jobs-to-be-done theory, which aids companies in determining how to create products and services that customers want to buy by getting at the causal driver behind a purchase. Christensen uses the term *job* as shorthand for what an individual wants to accomplish in a given circumstance, often with social, emotional, and functional dimensions. For example, two jobs that a newspaper does for its readers are to inform and entertain, whereas the jobs to be done of a newspaper are completely different for another customer segment—advertisers. A newspaper's jobs to be done for advertisers, for instance, may include promotions, attracting customers, or selling products. The jobs-to-be-done approach has also been incorporated into the development of business models in the form of customer empathy maps and value proposition canvases covered.[20]

LINK TO LEARNING

Watch this video illustrating Christensen's jobs-to-be-done theory through a milkshake (https://openstax.org/l/52ChristenMilk) to learn more.

After you watch this video, think about how Christensen's definition of jobs relates to innovation. What are some jobs to be done for your entrepreneurial idea?

Disruptive innovations are contrasted with sustaining technologies, which improve the performance of established products through characteristics that mainstream customers adopt. Disruptive technologies allow for new entrants in the market, often with simpler, more affordable, more convenient products. Entrepreneurs and marketers have difficulty predicting or projecting how the emergence of an innovation will occur, and anticipating how customers will react to the new offerings. Predicting who the early adopters will be can also be difficult during the early stage of an innovation's emergence. The mainstream customer base initially fails to find value in the new product. New customer segments, however, see value in the new features and lower prices. Eventually, developments improve the new product's features to a level that will satisfy mainstream customers and thus attract more of the mainstream market.[21]

20 Clayton M. Christensen, Taddy Hall, Karen Dillon, and David S. Duncan. "Know Your Customers' 'Jobs to Be Done'." *Harvard Business Review*. September 2016. https://hbr.org/2016/09/know-your-customers-jobs-to-be-done

21 Christian Hopp, David Antons, Jermain Kaminski, and Torsten Oliver Salge. "What 40 Years of Research Reveals about the Difference between Disruptive and Radical Innovation." *Harvard Business Review*. April 9, 2018. https://hbr.org/2018/04/what-40-years-of-research-reveals-about-the-difference-between-disruptive-and-radical-innovation

WORK IT OUT

Ride Sharing

Figure 11.5 Uber and Lyft are popular ride-sharing services. (credit: "navigation car drive road gps" by "DariuszSankowski"/Pixabay, CC0)

Ride-sharing services disrupted the traditional taxicab business by providing a mobile platform that connected ride-seeking consumers with drivers willing to provide transportation. In rapidly becoming the market leader of ride-sharing services, Uber became the poster child for disruptive innovation. A customer using a ride-sharing service like Uber or Lyft no longer had to wave down a cab on the street, nor did she need cash in hand anymore through its mobile payment system within the app. An Uber ride usually costs less than a regular cab ride. Ride-sharing services also offer more versatility in choices and greater overall convenience. Now Uber continues to evolve its model, adding options like Uber Eats and Uber Copter.

- What are the jobs to be done that Uber addresses?
- What areas of a taxi cab's business model does Uber disrupt?

Christensen prefers the term *disruptive innovation* to *disruptive technology* because even in his original theoretical framework, technology was not the driving force disrupting existing markets, products, and models—rather, business models were.[22] The root of the tension in disruptive innovation is the conflict between the previously established business model for the incumbent technology and the new business model that may be necessary for exploiting the disruptive technology or process.

The efforts of incumbents to capitalize on a disruptive technology will fail in most instances because commercializing the new technology will require a different business model from the one that the incumbents currently use. When disruption occurs, incumbents struggle to commercialize, whereas new entrants take control through their mastery of the requisite new business models. Thus, a disruptive business model can fundamentally reshape profits within an industry because managers are faced with a technological disruption/innovation that alters their businesses, specifically their business models. This phenomenon is known as business model innovation.[23]

Business model innovation, as defined by Professor Constantinos Markides of the London Business School,

22 C. M. Christensen. *The Innovator's Dilemma*. (Boston: Harvard Business School Press, 1997), 13.
23 C. M. Christensen and M. Raynor. *The Innovator's Solution*. Boston: Harvard Business School Press, 2003.

occurs when an existing business fundamentally changes their business model.[24] In order to be an innovation, the "new business model must enlarge the existing economic pie, either by attracting new customers or by encouraging existing consumers to consume more." Disruptive innovations tend to require a business model that is not only different from but even in conflict with the traditional way of competing.[25] In contrast, radical innovations (see the preceding text) are new-to-the-world products that are disruptive to both consumers and producers.

In the context of disruptive innovation, business model innovation is distinct from open business model innovation, which leverages external ideas together with internal ones. We also can define a business model innovation as a reformulation of an existing product or service, including a shift in how it is provided to the end user. A business model innovation "leads to a new way of playing the game" and can consist of new performance attributes on price or distribution outlets.[26] Stitch Fix uses data to offer personal styling at scale and ships customized clothing boxes from its own in-house label and from 1,000 brands in its collection directly to customers who want to avoid the hassles of in-store shopping. Despite volatility from investors, which dropped its initial $5.1 billion valuation at offering by two-thirds over three months, the company continues to reinvent the $334 billion US apparel industry.[27]

Value Proposition

Entrepreneurs play a key role in determining the value of their products. Of course, there are financial measures of value such as economic performance, job creation, wealth, and growth measures. But more often than not, value creation at the outset of a new startup venture lies outside these financial realms and addresses instead individual value to customers. The **value proposition** in a business model, for example, is a summary describing the benefits (value) customers can expect from a particular product or service. Your value proposition describes the benefits customers can expect from your products and services.[28] The value proposition is an integral part of the business model canvas, which we will discuss in Designing the Business Model.

ENTREPRENEUR IN ACTION

From Odeo to Twitter

Evan Williams and Biz Stone, both ex-Google employees, began a podcasting platform startup called Odeo around 2005. According to an early engineer in the company, Blaine Cooke, they built and tested Odeo but never used it. Shortly after co-founder Noah Glass created Odeo's podcasting platform, Apple announced plans to include a podcasting platform in all of its iPods. Faced with the reality that many of Odeo's fourteen employees weren't using the product they had built and the emergence of a giant competitor with a tremendous unfair advantage in Apple, Williams decided Odeo's future wouldn't be in

24 Constantinos Markides. "Disruptive Innovation: In Need of Better Theory." *Journal of Product Innovation Management* 23 (2006): 19–25.
25 Constantinos Markides. "Disruptive Innovation: In Need of Better Theory." *Journal of Product Innovation Management* 23 (2006): 19–25.
26 Constantinos D. Charitou and Constantinos C. Markides, "Responses to Disruptive Strategic Innovation." *MITSloan Management Review*. January 15, 2003. https://sloanreview.mit.edu/article/responses-to-disruptive-strategic-innovation/
27 Lauren Smiley. "Stitch Fix's radical data driven way to sell clothes- $1.2 billion last year—is reinventing retail." *Fast Company*. February 19, 2019. https://www.fastcompany.com/90298900/stitch-fix-most-innovative-companies-2019
28 Alexander Osterwalder, Yves Pigneur, Gregory Bernarda, and Alan Smith. *Value Proposition Design: How to Create Products and Services Customers Want*. Hoboken, NJ: Wiley, 2015.

podcasting.

The company held hackathons among employees and began searching for a pivot. One of those fourteen Odeo employees, Jack Dorsey, focused his efforts on the problem of status, the position of affairs at a particular time. In February 2006, Dorsey, Glass, and Florian Weber, a German contract developer, presented what they called Twttr, a system whereby a user could send a text message to a phone number, and it would be broadcast to the user's friends. A month later, Odeo had a working Twttr prototype, while obsessed employees were racking up hundreds of dollars in text messaging bills using the product. By the fall, Twitter (as it was now called) had thousands of users. Many began to see the product's utility after a San Francisco earthquake when it was heavily used to broadcast messages throughout the Bay Area.

- What type of innovation would you consider the original Odeo platform? Why?
- Why did Apple have an "unfair advantage" with its podcasting platform over competitors like Odeo?
- What value proposition did the early version of Twttr offer its users?

11.2 Designing the Business Model

Portions of the material in this section are based on original work by Geoffrey Graybeal and produced with support from the Rebus Community. The original is freely available under the terms of the CC BY 4.0 license at https://press.rebus.community/media-innovation-and-entrepreneurship/.

Learning Objectives

By the end of this section, you will be able to:

- Define a business model and its purpose
- Describe a business model canvas
- Describe a lean model canvas
- Describe a social business model canvas

According to Alexander Osterwalder and Yves Pigneur, the authors of *Business Model Generation*, a business model "describes the rationale of how an organization creates, delivers and captures value." Nevertheless, there is no single definition of this term, and usage varies widely.[29]

In standard business usage, a **business model** is a plan for how venture will be funded; how the venture creates value for its stakeholders, including customers; how the venture's offerings are made and distributed to the end users; and the how income will be generated through this process. The business model refers more to the design of the business, whereas a business plan is a planning document used for operations.

Each business model is unique to the company it describes. A typical business model addresses the desirability, feasibility, and viability of a company, product, or service. At a bare minimum, a business model needs to address revenue streams (e.g., a revenue model), a value proposition, and customer segments. In non-jargon English, this means you want to address what your idea is, who will use it, why they will use it, and how you will make money off it.

29 Alexander Osterwalder and Yves Pigneur. *Business Model Generation: A Handbook for Visionaries, Game Changers, and Challengers.* Hoboken, NJ: Wiley, 2010.

A canvas is a display that would-be entrepreneurs commonly use to map out and plan different components of their business models. There are several different types of canvases, with the business model canvas and the lean canvas being the most commonly used. There are hard-copy canvases modeled after an art canvas as well as digital versions. The original physical canvases are meant to serve as visual tools, used with sticky notes and sketches.

As developed by Osterwalder and Pigneur, the **business model canvas** has nine components, as shown in Figure 11.6.

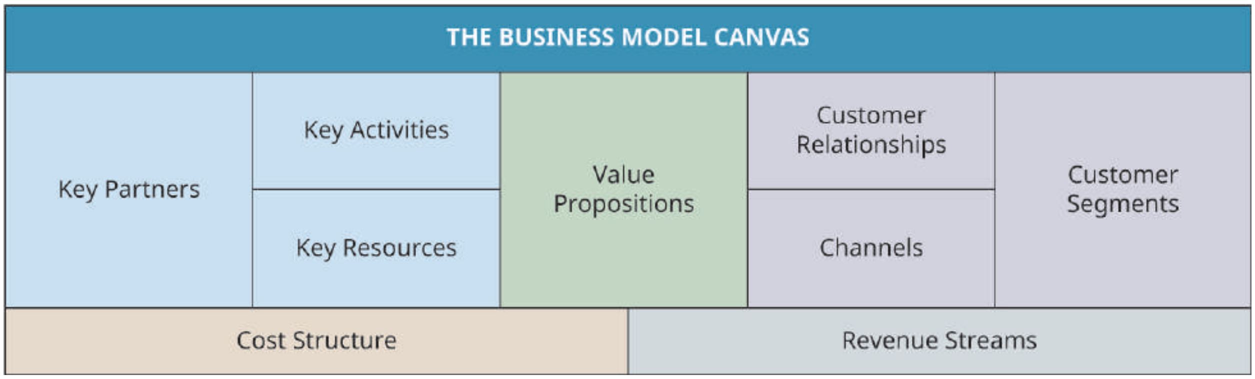

Figure 11.6 The business model canvas can be used to map or lay out the initial concept of your business. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

LINK TO LEARNING

Visit this site to see examples of completed Business Model Canvases for a variety of industries (https://openstax.org/l/52BMCsamples) for a deeper understanding of how the different categories are filled in.

Osterwalder and Pigneur wrote *Value Proposition Design* as a sequel to *Business Model Generation*. Their value proposition canvas is a plug-in that complements the business model canvas, going in depth on activities such as encouraging entrepreneurs to address and tackle customer pains, gains, and jobs-to-be-done trigger questions, and designing pain relievers and gains. The complementary and accompanying activities and resources can be useful for a deeper dive into and understanding of customer value creation in the form of value proposition, although there are other approaches to conceptualizing your value proposition. For Christensen, the originator of the disruptive innovation and jobs-to-be-done theories, a value proposition is a product that helps customers do a job they've been trying to do more effectively, conveniently, and affordably.

Finding the intersection of your customers' problems and your solutions is how you create a unique value proposition, according to the entrepreneur Ash Maurya, the author of *Scaling Lean* and *Running Lean*. In *Running Lean*, Maurya offers the following formula for creating an initial value proposition in the canvas, as shown in Figure 11.7.

Figure 11.7 Maurya’s formula to determine value proposition considers customer needs and potential objections within a specific period of time. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Maurya deviated from the standard business model canvas to create the lean canvas. It overlaps the business model canvas in five of the nine components: customer segments, value proposition, revenue streams, channels, and cost structure (Figure 11.8). Rather than addressing key partners, key activities, and key resources, the lean canvas helps you tackle problems, solutions, and key metrics instead.

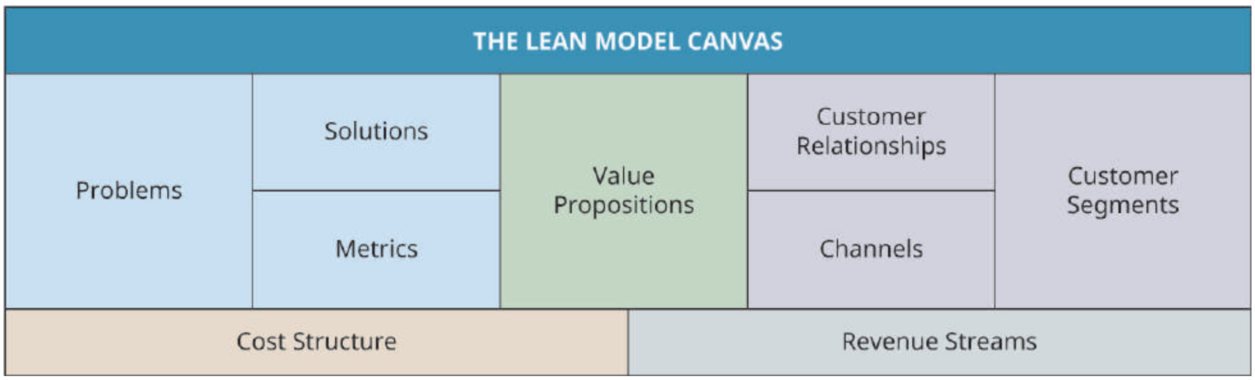

Figure 11.8 The lean model canvas is a modification of the Business Model Canvas. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

LINK TO LEARNING

Visit this site to see examples of completed Lean Model Canvases from some major companies (https://openstax.org/l/52LMCsamples) for a deeper understanding of how the canvas can be applied.

While the business model canvas and the lean canvas are similar in format, there are differences in how they are used. It is generally accepted that the lean canvas model is a better fit for startups, whereas the business model canvas works well for already established businesses. The lean canvas is simpler; the business model canvas provides a more complete picture of a mature business.

LINK TO LEARNING

Watch this Railsware video that demonstrates how the lean canvas model might be applied to startups (https://openstax.org/l/52LeanCanvUb) to learn more. In the case example in the video, the lean canvas model is applied to the successful P2P ride-sharing app Uber, as if it were a startup.

Both the business model canvas and the lean canvas are designed for constant iterations, allowing for multiple versions and changes throughout the entrepreneurial process. Part of that process involves customer discovery; thus, the canvases invoke customer-focused design. The target customer is integrated into the canvas from the start through the use of a customer empathy map and a number of design-thinking ideation activities.[30] The **customer empathy map** is a portrayal of a target customer—the most promising candidate from a business's customer segments—that explores the understanding of that person's condition from their perspective to understand his or her problems and needs (Figure 11.9). Osterwalder and Pigneur used a customer empathy map as part of the design ideation phase of developing a business model canvas. There are differing versions of customer empathy maps, but most seek to answer common questions pertaining to the customer, such as:

- With whom are we empathizing?
- What do they need to do?
- What do they see?
- What do they say?
- What do they do?
- What do they hear?
- What do they think?

Phillips, Proctor & Gamble, Microsoft, and Yeti are examples of well-known companies that make use of customer empathy mapping because, according to the journal *Entrepreneur*, every transaction can be turned into a meaningful and valuable customer interaction.[31] Once a company analyzes the results of customer mapping exercises, it may very well lead to new products that serve customer needs and/or wants.

For example, Philips used empathy mapping to detect a high level of fear in young patients immediately before an MRI medical procedure, so it invented a miniature version of the CAT scan equipment used in the procedure called the "kitten scanner" along with toy animal characters that were used to dispel the fear of MRIs among children. Proctor & Gamble created a new advertisement that was released for the 2012 Olympics visualizing the trials and tribulations of mothers raising young athletes, demonstrating Proctor and Gamble's awareness that some of its customers wanted or needed empathy for the sacrifices they had made to help their children succeed. Likewise, Microsoft has attempted to demonstrate empathy with customers' privacy concerns by developing an interactive website that explains not only how data is stolen but also how we can better protect our own data.[32]

On their company website, the now-famous Yeti cooler company publicly extols the value of empathy mapping, explaining that it leads to better products. Yeti doesn't just create one on its own, it actually asks its clients to work with the company to create an empathy map.[33] Thus, empathy mapping for Yeti is part of its product development process.

Customer empathy maps also strive to address customer pains (in this case, fears, frustrations, and anxieties) and gains (wants, needs, hopes, and dreams).[34]

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30 Charlene Perrin. "Create A Customer Empathy Map in 6 Easy Steps!" *Conceptboard*. March 28, 2019. https://conceptboard.com/blog/create-a-customer-empathy-map-in-6-easy-steps/

31 Vineet Arya. "How to Infuse Empathy in Your Marketing?" *Entrepreneur*. June 28, 2019. https://www.entrepreneur.com/article/335987

32 Vineet Arya. "How to Infuse Empathy in Your Marketing?" *Entrepreneur*. June 28, 2019. https://www.entrepreneur.com/article/335987

33 Mike Godlewski. "The Secret to Knowing What a Client Is Thinking? Empathy Maps." Yeti. February 8, 2016. https://yeti.co/blog/the-secret-to-knowing-what-your-client-is-thinking-empathy-maps/

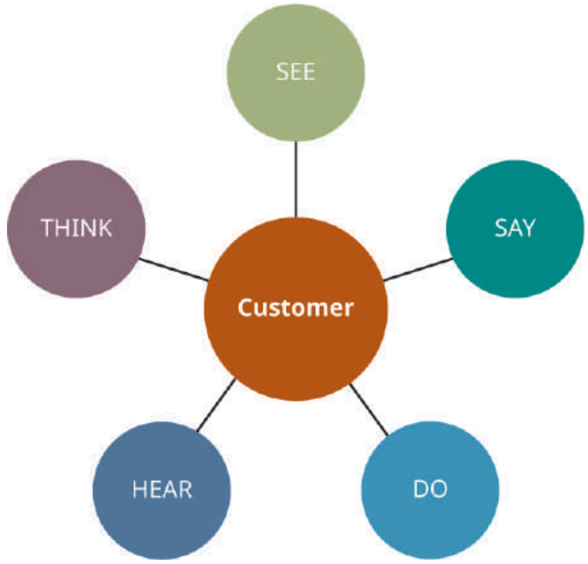

Figure 11.9 An empathy map portrays the target customer in order to understand the market needs. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

LINK TO LEARNING

Strategyzer offers six videos outlining the business model canvas (https://openstax.org/l/52BMCvideos) that total about 12 minutes; specifically they cover the prototyping journey from ideation to visualization of conceptualization.

Business Model Canvas[35]

As Osterwalder and Pigneur describe it, according to *Media Innovation and Entrepreneurship*, their business model canvas blocks include revenue streams, customer segments, value propositions, cost structures, channels, key activities, key partners, key resources, and customer relationships.

Early on, your greatest focus should be on the right side of the canvas because:

- These are, in many ways, the most critical aspects of starting a new venture (customer segments, value propositions, channels, and revenue streams).
- The most fluid (revenue streams, channels, and value propositions will likely differ for the differing customer segments and, as you iterate and adapt throughout the customer discovery process, could likely change).
- These follow a logical temporal order (there's no need to focus on the costs of building a company if you won't have customers).

In a follow-up to business model generation, the Strategyzer team created a second canvas, the value proposition canvas: https://www.strategyzer.com/canvas/value-proposition-canvas. The value proposition

34 Germán Coppola. "What Is an Empathy Map, and Why Is It Valuable for Your Business?" *Medium*. November 28, 2017. https://medium.com/swlh/what-is-an-empathy-map-and-why-is-it-valuable-for-your-business-14236be4fdf4

35 This material is based on original work by Geoffrey Graybeal and produced with support from the Rebus Community. The original is freely available under the terms of the CC BY 4.0 license at https://press.rebus.community/media-innovation-and-entrepreneurship/.

canvas is a new tool that pulls out the customer segment and value proposition blocks of the business model canvas, and encourages more in-depth exploration of those blocks to achieve a good fit between the two. The value proposition canvas tool looks at customer pains, gains and jobs to be done on the customer side and painkillers, gain creators, and products and services on the value proposition side.[36]

LINK TO LEARNING

Read this blog that provides a walk-through of how to fill in a value proposition canvas (https://openstax.org/l/52VPfillin) to learn more.

When you peel away the language used to describe business models, the early startup planning stages come down to a series of questions. When it comes to formulating a business model for a startup concept, another popular framework used in entrepreneurial circles is that of desirability-feasibility-viability Figure 11.10). This framework forces the entrepreneur to address broad questions about the startup concept:

- Desirability: How desirable is the product? Who will use it and why?
- Feasibility: How feasible is this idea? What are the costs of making it? How practical is the concept?
- Viability: Will this idea remain viable? How will it make money? How will it be sustained over time?

These questions then begin to connect to form a narrative about where the startup concept came from, whom it serves, why it's needed, how it will make money, and how it will be sustained in the future.

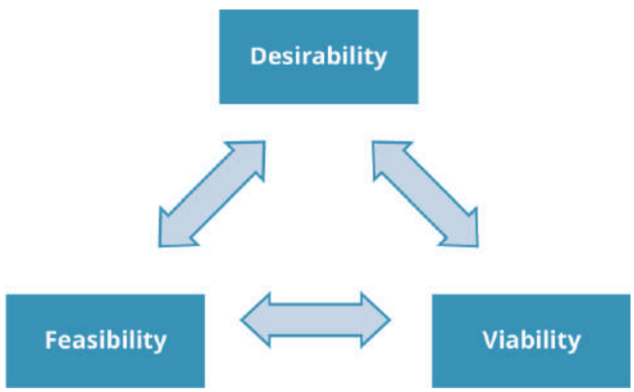

Figure 11.10 The framework of desirability, feasibility, and viability form a story about a company's startup. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

The value propositions, customer relationships, customer segments, and channels address the assumptions that will create customer value (desirability). The cost structure and revenue stream blocks are aimed at viability, or overcoming flawed business models. The key partners, key activities, and key resources are about execution and address feasibility. The risk of poor execution can undermine your assumptions that you chose the right infrastructure to execute your business model (feasibility). The risk of solving an irrelevant customer job (sometimes derisively labeled "a solution in search of a problem") undercuts desirability in your business. The risk of a flawed business model would hamper the financial assumption that your business will earn more money than you spend (viability). Adaptability is about the assumption that you chose the right business

36 Michelle Ferrier and Elizabeth Mays. *Media Innovation and Entrepreneurship*. The Rebus Foundation, 2017. https://press.rebus.community/media-innovation-and-entrepreneurship/.

model within the context of external factors such as technology change, competition, and regulation.

The business model canvas is not an exhaustive planning tool by any means.[37],[38] The risk of such external threats is not specifically addressed on the canvas blocks. The external threats not specifically covered by the canvas blocks can be designed for adaptability, that is, the business model canvas is a necessary but insufficient component of determining the viability of the business idea/concept. There are many elements not included in the canvas that entrepreneurs must address. Industry analysis, including a competitive analysis, for example, falls "off canvas" but is important nonetheless.

The Lean Model Canvas

The **lean model canvas** is Ash Maurya's adaptation of the original business model canvas. As we noted earlier, gone are the customer relationships, key activities, key partners, and key resources blocks. Instead, a problem block is added, because as Maurya explains, "Most startups fail, not because they fail to build what they set out to build, but because they waste time, money and effort building the wrong product. I attribute a significant contributor to this failure to a lack of proper 'problem understanding' from the start." Maurya next added a solution block to the lean model canvas, which corresponds well with features on a minimum viable product (MVP), which you will recall was covered in depth in Launch for Growth to Success. The lean model canvas also adds an "Unfair Advantage" block, similar to the block for competitive advantages or barriers to entry found in a business plan.[39]

Social Business Model Canvas

As you've noticed by now, the core canvas components are common throughout the various versions. Many of the blocks of the **social business model canvas** are similar to those used in the business model canvas and the lean model canvas.[40] A few differences, as developed by Tandemic, focus on areas unique to social entrepreneurship ventures. For example, the new areas added include measures of what kind of social impact you are creating or developing, measures of surplus to address what happens with profits and where you intend to reinvest them, and measures of beneficiary segments, and social and customer value propositions.[41] These could be measures such as the number of trees planted, number of refugees housed and fed, jobs created, or investments made—depending on the venture. Social impact looks at an organization's social mission beyond the bottom line. Measurement can differ among social entrepreneurs, but in terms of the canvas, impact measures are an effort to establish quantifiable metrics.

Social impact can be hard to measure, but nonetheless, many social entrepreneurs aim for long-lasting impact.[42] A 2014 report by the think tank, consultancy, and member network SustainAbility lists cooperative ownership, inclusive sourcing, and the "buy one, give one" model as three forms of social impact.[43] In addition to the Tandemic social business model canvas, there are other versions of similar canvases used for

37 Jennifer van der Meer. "Do You Suffer from Value Proposition Confusion?" *Linkedin*. October 19, 2016. https://www.linkedin.com/pulse/do-you-suffer-from-value-proposition-confusion-jennifer-van-der-meer/

38 "The Value Proposition Canvas." *Strategyzer*. n.d. https://strategyzer.com/canvas/value-proposition-canvas

39 Ash Maurya. "Why Lean Canvas vs Business Model Canvas?" *Medium*. February 27, 2012. https://blog.leanstack.com/why-lean-canvas-vs-business-model-canvas-af62c0f250f0

40 "Social Business Model Canvas." *Business Model Toolbox*. 2013. https://bmtoolbox.net/tools/social-business-model-canvas/

41 "The Business Model Canvas Reinvented for Social Business." *Tandemic*. n.d. http://www.socialbusinessmodelcanvas.com

42 Ayse Guclu, J. Gregory Dees, and Beth Battle Anderson. "The Process of Social Entrepreneurship: Creating Opportunities Worthy of Serious Pursuit." *Duke/Fuqua case*. 2002. https://centers.fuqua.duke.edu/case/knowledge_items/the-process-of-social-entrepreneurship-creating-opportunities-worthy-of-serious-pursuit/

43 Lindsay Clinton and Ryan Whisnant. "Model Behavior: 20 Business Model Innovations for Sustainability." *SustainAbility*. February 2014. https://sustainability.com/wp-content/uploads/2016/07/model_behavior_20_business_model_innovations_for_sustainability.pdf

social entrepreneurship. For instance, Osterwalder adapted the business model canvas for mission-driven organizations into a mission model canvas.[44] There's also a social lean canvas that adds purpose (explaining your reason for creating the venture in terms of social or environmental problems) and impact sections (describing the intended social or environmental impact).[45]

LINK TO LEARNING

This completed social business model canvas for the popular peer-to-peer lending platform Kiva (https://openstax.org/l/52SocialBMC) illustrates how the business model canvas can and perhaps should be adapted for social entrepreneurship ventures.

WHAT CAN YOU DO?

TOMS Shoes

Toms Shoes is perhaps one of the best-known companies for adopting a social entrepreneurship purpose into its business model. Part of its early success hinged on the fact that for every pair of shoes a customer bought, the company donated a pair of shoes to someone in need. The company won a prize in 2006 for its innovative solution to poverty. This "1-for-1 business model," sometimes commonly called the "Toms model" after the shoe company that popularized it, gained traction among other companies that followed suit in similar fashion, seeing both the social and the financial successes in the Toms model. Warby Parker is another example of a company that does essentially the same: A customer purchases a pair of eyeglasses, and the company donates a pair (although Warby Parker pays a third party to procure the glasses, as eyeglasses require an individual prescription, whereas shoes do not).

- Can you think of an innovative social entrepreneurship business model?

44 Alexander Osterwalder. "The Mission Model Canvas: An Adapted Business Model Canvas for Mission-Driven Organizations." *Strategyzer*. February 25, 2016. https://blog.strategyzer.com/posts/2016/2/24/the-mission-model-canvas-an-adapted-business-model-canvas-for-mission-driven-organizations

45 Social Lean Canvas. n.d. https://socialleancanvas.com/

WHAT CAN YOU DO?

The Birthday Party Project

Figure 11.11 The Birthday Party Project helps provide celebrations to honor the birthdays of homeless children. (credit: modification of "children's birthday table" by "Efraimstochter"/Pixabay, CC0)

Paige Chenault wanted homeless children in Dallas to feel special on their birthdays. Many have never experienced a birthday party. So this professional event planner sprang into action in January 2012. She launched the Birthday Party Project (https://www.thebirthdaypartyproject.org/), a nonprofit group whose mission is to celebrate the lives of homeless children (ages one to twenty-two). The group organizes monthly birthday parties with partner shelters. Since its inception, the concept has spread beyond Texas to cities across the United States, including Atlanta, Chicago, Los Angeles, New York, and San Francisco. In six years, the Birthday Party Project has celebrated 4,800 birthdays with 30,000 kids in attendance, eaten 40,000 cupcakes, cracked 30,000 glow sticks, and performed 1,100 renditions of "Happy Birthday."

- Identify a need in your community that could become a social entrepreneurship business, as Paige discovered with an initial passion project.

11.3 Conducting a Feasibility Analysis

Learning Objectives

By the end of this section, you will be able to:

- Describe the purpose of a feasibility analysis
- Describe and develop the parts of a feasibility analysis
- Understand how to apply feasibility outcomes to a new venture

As the name suggests, a **feasibility analysis** is designed to assess whether your entrepreneurial endeavor is, in fact, feasible or possible. By evaluating your management team, assessing the market for your concept, estimating financial viability, and identifying potential pitfalls, you can make an informed choice about the achievability of your entrepreneurial endeavor. A feasibility analysis is largely numbers driven and can be far more in depth than a business plan (discussed in The Business Plan). It ultimately tests the viability of an idea, a project, or a new business. A feasibility study may become the basis for the business plan, which outlines the action steps necessary to take a proposal from ideation to realization. A feasibility study allows a business to address where and how it will operate, its competition, possible hurdles, and the funding needed to begin. The business plan then provides a framework that sets out a map for following through and executing on the entrepreneurial vision.

Organizational Feasibility Analysis

Organizational feasibility aims to assess the prowess of management and sufficiency of resources to bring a product or idea to market Figure 11.12. The company should evaluate the ability of its management team on areas of interest and execution. Typical measures of management prowess include assessing the founders' passion for the business idea along with industry expertise, educational background, and professional experience. Founders should be honest in their self-assessment of ranking these areas.

Figure 11.12 An analysis of organizational feasibility focuses on resource needs and management capabilities. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Resource sufficiency pertains to nonfinancial resources that the venture will need to move forward successfully and aims to assess whether an entrepreneur has a sufficient amount of such resources. The organization should critically rank its abilities in six to twelve types of such critical nonfinancial resources, such as availability of office space, quality of the labor pool, possibility of obtaining intellectual property protections (if applicable), willingness of high-quality employees to join the company, and likelihood of forming favorable strategic partnerships. If the analysis reveals that critical resources are lacking, the venture may not be possible as currently planned.[46]

46 Ulrich Kaiser. "A primer in Entrepreneurship – Chapter 3 Feasibility analysis" *University of Zurich Institute for Strategy and Business Economics*. n.d. https://docplayer.net/7775267-A-primer-in-entrepreneurship-chapter-3-feasibility-analysis.html

Financial Feasibility Analysis

A **financial analysis** seeks to project revenue and expenses (forecasts come later in the full business plan); project a financial narrative; and estimate project costs, valuations, and cash flow projections Figure 11.13.

Figure 11.13 An analysis of financial feasibility focuses on expenses, cash flow, and projected revenue. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

The financial analysis may typically include these items:

- A twelve-month profit and loss projection
- A three- or four-year profit-and-loss projection
- A cash-flow projection
- A projected balance sheet
- A breakeven calculation

The financial analysis should estimate the sales or revenue that you expect the business to generate. A number of different formulas and methods are available for calculating sales estimates. You can use industry or association data to estimate the sales of your potential new business. You can search for similar businesses in similar locations to gauge how your business might perform compared with similar performances by competitors. One commonly used equation for a sales model multiplies the number of target customers by the average revenue per customer to establish a sales projection:

$$\text{T} \times \text{A} = \text{S}$$
$$\text{Target(ed) Customers / Users} \times \text{Average Revenue per Customer} = \text{Sales Projection}$$

Another critical part of planning for new business owners is to understand the **breakeven point**, which is the level of operations that results in exactly enough revenue to cover costs (see Entrepreneurial Finance and Accounting for an in-depth discussion on calculating breakeven points and the breakdown of cost types). It yields neither a profit nor a loss. To calculate the breakeven point, you must first understand the two types of costs: fixed and variable. **Fixed costs** are expenses that do not vary based on the amount of sales. Rent is one example, but most of a business's other costs operate in this manner as well. While some costs vary from month to month, costs are described as variable only if they will increase if the company sells even one more item. Costs such as insurance, wages, and office supplies are typically considered fixed costs. **Variable costs** fluctuate with the level of sales revenue and include items such as raw materials, purchases to be sold, and direct labor. With this information, you can calculate your breakeven point—the sales level at which your business has neither a profit nor a loss.[47] Projections should be more than just numbers: include an explanation of the underlying assumptions used to estimate the venture's income and expenses.

Projected cash flow outlines preliminary expenses, operating expenses, and reserves—in essence, how much you need before starting your company. You want to determine when you expect to receive cash and when you have to write a check for expenses. Your cash flow is designed to show if your working capital is adequate. A **balance sheet** shows assets and liabilities, necessary for reporting and financial management. When liabilities are subtracted from assets, the remainder is owners' equity. The financial concepts and statements introduced here are discussed fully in Entrepreneurial Finance and Accounting.

Market Feasibility Analysis

A **market analysis** enables you to define competitors and quantify target customers and/or users in the market within your chosen industry by analyzing the overall interest in the product or service within the industry by its target market Figure 11.14. You can define a market in terms of size, structure, growth prospects, trends, and sales potential. This information allows you to better position your company in competing for market share. After you've determined the overall size of the market, you can define your target market, which leads to a **total available market (TAM)**, that is, the number of potential users within your business's sphere of influence. This market can be segmented by geography, customer attributes, or product-oriented segments. From the TAM, you can further distill the portion of that target market that will be attracted to your business. This market segment is known as a **serviceable available market (SAM)**.

Figure 11.14 An analysis of market feasibility examines the overall market and focuses on the anticipated share of the target market. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Projecting market share can be a subjective estimate, based not only on an analysis of the market but also on pricing, promotional, and distribution strategies. As is the case for revenue, you will have a number of different forecasts and tools available at your disposal. Other items you may include in a market analysis are a complete competitive review, historical market performance, changes to supply and demand, and projected growth in

47 In a preliminary financial model and business plan, startup costs should be allocated, as they are intended for one-time investments in development; pre-launch costs and other necessary expenses will not carry over once the product/solution has launched.

demand over time.

ARE YOU READY?

Market Feasibility Analysis

You've been hired by a leading hotel chain to determine the market and financial potential for the development of a mixed-use property that will include a full-service hotel in downtown Orlando, located at 425 East Central Boulevard, in Orlando, Florida. The specific address is important so you can pinpoint existing competitors and overall suitability of the site. Using the information given, conduct a market analysis that can be part of a larger feasibility study.

WORK IT OUT

Location Feasibility

Figure 11.15 If you wanted to open a business in downtown Atlanta, you would need to research the feasibility of operating a location there. (credit: "Atlanta,Georgia,downtown skyline,dusk" by "tableatny"/Flickr, CC BY 2.0)

You're considering opening a boutique clothing store in downtown Atlanta. You've read news reports about how downtown Atlanta and the city itself are growing and undergoing changes from previous decades. With new development taking place there, you're not sure whether such a venture is viable. Outline what steps you would need to take to conduct a feasibility study to determine whether downtown Atlanta is the right location for your planned clothing store.

Applying Feasibility Outcomes

After conducting a feasibility analysis, you must determine whether to proceed with the venture. One technique that is commonly used in project management is known as a **go-or-no-go decision**. This tool allows a team to decide if criteria have been met to move forward on a project. Criteria on which to base a decision are established and tracked over time. You can develop criteria for each section of the feasibility analysis to determine whether to proceed and evaluate those criteria as either “go” or “no go,” using that assessment to make a final determination of the overall concept feasibility. Determine whether you are comfortable proceeding with the present management team, whether you can “go” forward with existing nonfinancial resources, whether the projected financial outlook is worth proceeding, and make a determination on the market and industry. If satisfied that enough “go” criteria are met, you would likely then proceed to developing your strategy in the form of a business plan.

WHAT CAN YOU DO?

Love Beyond Walls

When Terence Lester saw a homeless man living behind an abandoned, dilapidated building, he asked the man if he could take him to a shelter. The man scoffed, replying that Lester should sleep in a shelter. So he did—and he saw the problem through the homeless man’s perspective. The shelter was crowded and smelly. You couldn’t get much sleep, because others would try to steal your meager belongings. The dilapidated building provided isolation away from others, but quiet and security in its own way that the shelter could not. This experience led Lester to voluntarily live as a homeless person for a few weeks. His journey led him to create Love Beyond Walls (www.lovebeyondwalls.org), an organization that aids the homeless, among other causes. Lester didn’t conduct a formal feasibility study, but he did so informally by walking in his intended customers’ shoes—literally. A feasibility study of homelessness in a particular area could yield surprising findings that might lead to social entrepreneurial pursuits.

- What is a social cause you think could benefit from a formal feasibility study around a potential entrepreneurial solution?

11.4 The Business Plan

Learning Objectives

By the end of this section, you will be able to:

- Describe the different purposes of a business plan
- Describe and develop the components of a brief business plan
- Describe and develop the components of a full business plan

Unlike the brief or lean formats introduced so far, the **business plan** is a formal document used for the long-range planning of a company’s operation. It typically includes background information, financial information, and a summary of the business. Investors nearly always request a formal business plan because it is an integral part of their evaluation of whether to invest in a company. Although nothing in business is permanent, a business plan typically has components that are more “set in stone” than a business model canvas, which is more commonly used as a first step in the planning process and throughout the early stages of a nascent business. A business plan is likely to describe the business and industry, market strategies, sales potential, and competitive analysis, as well as the company's long-term goals and objectives. An in-depth formal business plan would follow at later stages after various iterations to business model canvases. The business plan usually projects financial data over a three-year period and is typically required by banks or other investors to secure funding. The business plan is a roadmap for the company to follow over multiple years.

Some entrepreneurs prefer to use the canvas process instead of the business plan, whereas others use a shorter version of the business plan, submitting it to investors after several iterations. There are also entrepreneurs who use the business plan earlier in the entrepreneurial process, either preceding or concurrently with a canvas. For instance, Chris Guillebeau has a one-page business plan template in his book *The $100 Startup*.[48] His version is basically an extension of a napkin sketch (see the "Are You Ready?" activity in Designing the Business Model), without the detail of a full business plan. As you progress, you can also consider a brief business plan (about two pages)—if you want to support a rapid business launch—and/or a standard business plan.

As with many aspects of entrepreneurship, there are no clear hard and fast rules to achieving entrepreneurial success. You may encounter different people who want different things (canvas, summary, full business plan), and you also have flexibility in following whatever tool works best for you. Like the canvas, the various versions of the business plan are tools that will aid you in your entrepreneurial endeavor.

Business Plan Overview

Most business plans have several distinct sections (Figure 11.16). The business plan can range from a few pages to twenty-five pages or more, depending on the purpose and the intended audience. For our discussion, we'll describe a brief business plan and a standard business plan. If you are able to successfully design a business model canvas, then you will have the structure for developing a clear business plan that you can submit for financial consideration.

BUSINESS PLAN	
√	Executive Summary
√	Business Description
√	Market Strategies
√	Marketing Plan
√	Competitive Analysis
√	Operations and Management Plan
√	Financial Analysis
√	Design and Development Plan

Figure 11.16 Most business plans include the same important sections. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Both types of business plans aim at providing a picture and roadmap to follow from conception to creation. If you opt for the brief business plan, you will focus primarily on articulating a big-picture overview of your business concept.

48 Chris Guillebeau. *The $100 Startup: Reinvent the Way You Make a Living, Do What You Love, and Create a New Future*. New York: Crown Business/Random House, 2012.

The full business plan is aimed at executing the vision concept, dealing with the proverbial devil in the details. Developing a full business plan will assist those of you who need a more detailed and structured roadmap, or those of you with little to no background in business. The business planning process includes the business model, a feasibility analysis, and a full business plan, which we will discuss later in this section. Next, we explore how a business plan can meet several different needs.

Purposes of a Business Plan

A business plan can serve many different purposes—some internal, others external. As we discussed previously, you can use a business plan as an internal early planning device, an extension of a napkin sketch, and as a follow-up to one of the canvas tools. A business plan can be an organizational roadmap, that is, an internal planning tool and working plan that you can apply to your business in order to reach your desired goals over the course of several years. The business plan should be written by the owners of the venture, since it forces a firsthand examination of the business operations and allows them to focus on areas that need improvement.

Refer to the business venture throughout the document. Generally speaking, a business plan should not be written in the first person.

A major external purpose for the business plan is as an investment tool that outlines financial projections, becoming a document designed to attract investors. In many instances, a business plan can complement a formal investor's pitch. In this context, the business plan is a presentation plan, intended for an outside audience that may or may not be familiar with your industry, your business, and your competitors.

You can also use your business plan as a contingency plan by outlining some "what-if" scenarios and exploring how you might respond if these scenarios unfold. Pretty Young Professional launched in November 2010 as an online resource to guide an emerging generation of female leaders. The site focused on recent female college graduates and current students searching for professional roles and those in their first professional roles. It was founded by four friends who were coworkers at the global consultancy firm McKinsey. But after positions and equity were decided among them, fundamental differences of opinion about the direction of the business emerged between two factions, according to the cofounder and former CEO Kathryn Minshew. "I think, naively, we assumed that if we kicked the can down the road on some of those things, we'd be able to sort them out," Minshew said. Minshew went on to found a different professional site, The Muse, and took much of the editorial team of Pretty Young Professional with her.[49] Whereas greater planning potentially could have prevented the early demise of Pretty Young Professional, a change in planning led to overnight success for Joshua Esnard and The Cut Buddy team. Esnard invented and patented the plastic hair template that he was selling online out of his Fort Lauderdale garage while working a full-time job at Broward College and running a side business. Esnard had hundreds of boxes of Cut Buddies sitting in his home when he changed his marketing plan to enlist companies specializing in making videos go viral. It worked so well that a promotional video for the product garnered 8 million views in hours. The Cut Buddy sold over 4,000 products in a few hours when Esnard only had hundreds remaining. Demand greatly exceeded his supply, so Esnard had to scramble to increase manufacturing and offered customers two-for-one deals to make up for delays. This led to selling 55,000 units, generating $700,000 in sales in 2017.[50] After appearing on *Shark Tank* and landing a deal with

49 Jonathan Chan. "What These 4 Startup Case Studies Can Teach You about Failure." *Foundr.com*. July 12, 2015. https://foundr.com/4-startup-case-studies-failure/

50 Amy Feldman. "Inventor of the Cut Buddy Paid YouTubers to Spark Sales. He Wasn't Ready for a Video to Go Viral." *Forbes.* February 15, 2017. https://www.forbes.com/sites/forbestreptalks/2017/02/15/inventor-of-the-cut-buddy-paid-youtubers-to-spark-sales-he-wasnt-ready-for-a-video-to-go-viral/#3eb540ce798a

Daymond John that gave the "shark" a 20-percent equity stake in return for $300,000, The Cut Buddy has added new distribution channels to include retail sales along with online commerce. Changing one aspect of a business plan—the marketing plan—yielded success for The Cut Buddy.

LINK TO LEARNING

Watch this video of Cut Buddy's founder, Joshua Esnard, telling his company's story (https://openstax.org/l/52CutBuddy) to learn more.

If you opt for the brief business plan, you will focus primarily on articulating a big-picture overview of your business concept. This version is used to interest potential investors, employees, and other stakeholders, and will include a financial summary "box," but it must have a disclaimer, and the founder/entrepreneur may need to have the people who receive it sign a nondisclosure agreement (NDA). The full business plan is aimed at executing the vision concept, providing supporting details, and would be required by financial institutions and others as they formally become stakeholders in the venture. Both are aimed at providing a picture and roadmap to go from conception to creation.

Types of Business Plans

The brief business plan is similar to an extended executive summary from the full business plan. This concise document provides a broad overview of your entrepreneurial concept, your team members, how and why you will execute on your plans, and why you are the ones to do so. You can think of a brief business plan as a scene setter or—since we began this chapter with a film reference—as a trailer to the full movie. The brief business plan is the commercial equivalent to a trailer for *Field of Dreams*, whereas the full plan is the full-length movie equivalent.

Brief Business Plan

As the name implies, the **executive summary** summarizes key elements of the entire business plan, such as the business concept, financial features, and current business position. The executive summary version of the business plan is your opportunity to broadly articulate the overall concept and vision of the company for yourself, for prospective investors, and for current and future employees.

A typical executive summary is generally no longer than a page, but because the brief business plan is essentially an extended executive summary, the executive summary section is vital. This is the "ask" to an investor. You should begin by clearly stating what you are asking for in the summary.

In the business concept phase, you'll describe the business, its product, and its markets. Describe the customer segment it serves and why your company will hold a competitive advantage. This section may align roughly with the customer segments and value-proposition segments of a canvas.

Next, highlight the important financial features, including sales, profits, cash flows, and return on investment. Like the financial portion of a feasibility analysis, the financial analysis component of a business plan may typically include items like a twelve-month profit and loss projection, a three- or four-year profit and loss projection, a cash-flow projection, a projected balance sheet, and a breakeven calculation. You can explore a feasibility study and financial projections in more depth in the formal business plan. Here, you want to focus on the big picture of your numbers and what they mean.

The current business position section can furnish relevant information about you and your team members and the company at large. This is your opportunity to tell the story of how you formed the company, to describe its legal status (form of operation), and to list the principal players. In one part of the extended executive summary, you can cover your reasons for starting the business: Here is an opportunity to clearly define the needs you think you can meet and perhaps get into the pains and gains of customers. You also can provide a summary of the overall strategic direction in which you intend to take the company. Describe the company's mission, vision, goals and objectives, overall business model, and value proposition.

Rice University's Student Business Plan Competition, one of the largest and overall best-regarded graduate school business-plan competitions (see Telling Your Entrepreneurial Story and Pitching the Idea), requires an executive summary of up to five pages to apply.[51],[52] Its suggested sections are shown in Table 11.2.

Suggested Executive Summary Components for Rice University Business Plan Competition[53]

Section	Description
Company summary	Brief overview (one to two paragraphs) of the problem, solution, and potential customers
Customer analysis	Description of potential customers and evidence they would purchase product
Market analysis	Size of market, target market, and share of market
Product or service	Current state of product in development and evidence it is feasible
Intellectual property	If applicable, information on patents, licenses, or other IP items
Competitive differentiation	Describe the competition and your competitive advantage
Company founders, management team, and/or advisor	Bios of key people showcasing their expertise and relevant experience
Financials	Projections of revenue, profit, and cash flow for three to five years
Amount of investment	Funding request and how funds will be used

Table 11.2

51 Jennifer Post. "National Business Plan Competitions for Entrepreneurs." *Business News Daily*. August 30, 2018. https://www.businessnewsdaily.com/6902-business-plan-competitions-entrepreneurs.html

52 "Rice Business Plan Competition, Eligibility Criteria and How to Apply." *Rice Business Plan Competition*. March 2020. https://rbpc.rice.edu/sites/g/files/bxs806/f/2020%20RBPC%20Eligibility%20Criteria%20and%20How%20to%20Apply_23Oct19.pdf

53 "Rice Business Plan Competition, Eligibility Criteria and How to Apply." Rice Business Plan Competition. March 2020. https://rbpc.rice.edu/sites/g/files/bxs806/f/2020%20RBPC%20Eligibility%20Criteria%20and%20How%20to%20Apply_23Oct19.pdf; Based on 2019 RBPC Competition Rules and Format April 4–6, 2019. https://rbpc.rice.edu/sites/g/files/bxs806/f/2019-RBPC-Competition-Rules%20-Format.pdf

ARE YOU READY?

Create a Brief Business Plan

Fill out a canvas of your choosing for a well-known startup: Uber, Netflix, Dropbox, Etsy, Airbnb, Bird/Lime, Warby Parker, or any of the companies featured throughout this chapter or one of your choice. Then create a brief business plan for that business. See if you can find a version of the company's actual executive summary, business plan, or canvas. Compare and contrast your vision with what the company has articulated.

- These companies are well established but is there a component of what you charted that you would advise the company to change to ensure future viability?
- Map out a contingency plan for a "what-if" scenario if one key aspect of the company or the environment it operates in were drastically is altered?

Full Business Plan

Even full business plans can vary in length, scale, and scope. Rice University sets a ten-page cap on business plans submitted for the full competition. The IndUS Entrepreneurs, one of the largest global networks of entrepreneurs, also holds business plan competitions for students through its Tie Young Entrepreneurs program. In contrast, business plans submitted for that competition can usually be up to twenty-five pages. These are just two examples. Some components may differ slightly; common elements are typically found in a formal business plan outline. The next section will provide sample components of a full business plan for a fictional business.

Executive Summary

The executive summary should provide an overview of your business with key points and issues. Because the summary is intended to summarize the entire document, it is most helpful to write this section last, even though it comes first in sequence. The writing in this section should be especially concise. Readers should be able to understand your needs and capabilities at first glance. The section should tell the reader what you want and your "ask" should be explicitly stated in the summary.

Describe your business, its product or service, and the intended customers. Explain what will be sold, who it will be sold to, and what competitive advantages the business has. Table 11.3 shows a sample executive summary for the fictional company La Vida Lola.

Executive Summary for La Vida Lola

Executive Summary Component	Content
The Concept	La Vida Lola is a food truck serving the best Latin American and Caribbean cuisine in the Atlanta region, particularly Puerto Rican and Cuban dishes, with a festive flair. La Vida Lola offers freshly prepared dishes from the mobile kitchen of the founding chef and namesake Lola González, a Duluth, Georgia, native who has returned home to launch her first venture after working under some of the world's top chefs. La Vida Lola will cater to festivals, parks, offices, community and sporting events, and breweries throughout the region.
Market Advantage	Latin food packed with flavor and flair is the main attraction of La Vida Lola. Flavors steeped in Latin American and Caribbean culture can be enjoyed from a menu featuring street foods, sandwiches, and authentic dishes from the González family's Puerto Rican and Cuban roots. *Millennial foodies* craving ethnic food experiences and *Latin food lovers* are the primary customers, but anyone with a taste for delicious homemade meals in Atlanta can order. Having a native Atlanta-area resident returning to her hometown after working in restaurants around the world to share food with area communities offers a competitive advantage for La Vida Lola in the form of founding chef Lola González.
Marketing	The venture will adopt a concentrated marketing strategy. The company's promotion mix will comprise a mix of advertising, sales promotion, public relations, and personal selling. Much of the promotion mix will center around dual-language social media.
Venture Team	The two founding members of the management team have almost four decades of combined experience in the restaurant and hospitality industries. Their background includes experience in food and beverage, hospitality and tourism, accounting, finance, and business creation.
Capital Requirements	La Vida Lola is seeking startup capital of $50,000 to establish its food truck in the Atlanta area. An additional $20,000 will be raised through a donations-driven crowdfunding campaign. The venture can be up and running within six months to a year.

Table 11.3

Business Description

This section describes the industry, your product, and the business and success factors. It should provide a current outlook as well as future trends and developments. You also should address your company's mission, vision, goals, and objectives. Summarize your overall strategic direction, your reasons for starting the business, a description of your products and services, your business model, and your company's value proposition. Consider including the Standard Industrial Classification/North American Industry Classification System (SIC/NAICS) code to specify the industry and insure correct identification. The industry extends beyond where the business is located and operates, and should include national and global dynamics. Table 11.4 shows a sample business description for La Vida Lola.

Business Description for La Vida Lola	
Business Description	La Vida Lola will operate in the mobile food services industry, which is identified by SIC code 5812 Eating Places and NAICS code 722330 Mobile Food Services, which consist of establishments primarily engaged in preparing and serving meals and snacks for immediate consumption from motorized vehicles or nonmotorized carts. Ethnically inspired to serve a consumer base that craves more spiced Latin foods, La Vida Lola is an Atlanta-area food truck specializing in Latin cuisine, particularly Puerto Rican and Cuban dishes native to the roots of the founding chef and namesake, Lola González. La Vida Lola aims to spread a passion for Latin cuisine within local communities through flavorful food freshly prepared in a region that has embraced international eats. Through its mobile food kitchen, La Vida Lola plans to roll into parks, festivals, office buildings, breweries, and sporting and community events throughout the greater Atlanta metropolitan region. Future growth possibilities lie in expanding the number of food trucks, integrating food delivery on demand, and adding a food stall at an area food market. After working in noted restaurants for a decade, most recently under the famed chef José Andrés, chef Lola González returned to her hometown of Duluth, Georgia, to start her own venture. Although classically trained by top world chefs, it was González's grandparents' cooking of authentic Puerto Rican and Cuban dishes in their kitchen that influenced her profoundly. The freshest ingredients from the local market, the island spices, and her attention to detail were the spark that ignited Lola's passion for cooking. To that end, she brings flavors steeped in Latin American and Caribbean culture to a flavorful menu packed full of street foods, sandwiches, and authentic dishes. Through reasonably priced menu items, La Vida Lola offers food that appeals to a wide range of customers, from millennial foodies to Latin natives and other locals with Latin roots.

Table 11.4

Industry Analysis and Market Strategies

Here you should define your market in terms of size, structure, growth prospects, trends, and sales potential. You'll want to include your TAM and forecast the SAM. (Both these terms are discussed in Conducting a Feasibility Analysis.) This is a place to address market segmentation strategies by geography, customer attributes, or product orientation. Describe your positioning relative to your competitors' in terms of pricing, distribution, promotion plan, and sales potential. Table 11.5 shows an example industry analysis and market strategy for La Vida Lola.

Industry Analysis and Market Strategy for La Vida Lola	
Industry Analysis and Market Strategy	According to *Mobile Food Trends and Insights*' first annual report from the San Francisco-based Off The Grid, a company that facilitates food markets nationwide, the US food truck industry alone is projected to grow by nearly 20 percent from $800 million in 2017 to $985 million in 2019. Meanwhile, an *IBISWorld* report shows the street vendors' industry with a 4.2 percent annual growth rate to reach $3.2 billion in 2018. Food truck and street food vendors are increasingly investing in specialty, authentic ethnic, and fusion food, according to the *IBISWorld* report. Although the *IBISWorld* report projects demand to slow down over the next five years, it notes there are still opportunities for sustained growth in major metropolitan areas. The street vendors industry has been a particular bright spot within the larger food service sector. The industry is in a growth phase of its life cycle. The low overhead cost to set up a new establishment has enabled many individuals, especially specialty chefs looking to start their own businesses, to own a food truck in lieu of opening an entire restaurant. Off the Grid's annual report indicates the average typical initial investment ranges from $55,000 to $75,000 to open a mobile food truck. The restaurant industry accounts for $800 billion in sales nationwide, according to data from the National Restaurant Association. Georgia restaurants brought in a total of $19.6 billion in 2017, according to figures from the Georgia Restaurant Association. There are approximately 12,000 restaurants in the metro Atlanta region. The Atlanta region accounts for almost 60 percent of the Georgia restaurant industry. The SAM is estimated to be approximately $360 million. The mobile food/street vendor industry can be segmented by types of customers, types of cuisine (American, desserts, Central and South American, Asian, mixed ethnicity, Greek Mediterranean, seafood), geographic location and types (mobile food stands, mobile refreshment stands, mobile snack stands, street vendors of food, mobile food concession stands). Secondary competing industries include chain restaurants, single location full-service restaurants, food service contractors, caterers, fast food restaurants, and coffee and snack shops.

Table 11.5

Industry Analysis and Market Strategy for La Vida Lola

The top food truck competitors according to the *Atlanta Journal-Constitution*, the daily newspaper in La Vida Lola’s market, are Bento Bus, Mix’d Up Burgers, Mac the Cheese, The Fry Guy, and The Blaxican. Bento Bus positions itself as a Japanese-inspired food truck using organic ingredients and dispensing in eco-friendly ware. The Blaxican positions itself as serving what it dubs “Mexican soul food,” a fusion mashup of Mexican food with Southern comfort food. After years of operating a food truck, The Blaxican also recently opened its first brick-and-mortar restaurant. The Fry Guy specializes in Belgian-style street fries with a variety of homemade dipping sauces. These three food trucks would be the primary competition to La Vida Lola, since they are in the “ethnic food” space, while the other two offer traditional American food. All five have established brand identities and loyal followers/customers since they are among the industry leaders as established by “best of” lists from area publications like the *Atlanta Journal-Constitution*. Most dishes from competitors are in the $10–$13 price range for entrees. La Vida Lola dishes will range from $6 to $13.

One key finding from Off the Grid’s *Mobile Food Trends and Insights* report is that mobile food has “proven to be a powerful vehicle for catalyzing diverse entrepreneurship” as 30 percent of mobile food businesses are immigrant owned, 30 percent are women owned, and 8 percent are LGBTQ owned. In many instances, the owner-operator plays a vital role to the brand identity of the business as is the case with La Vida Lola.

Atlanta has also tapped into the nationwide trend of food hall-style dining. These food halls are increasingly popular in urban centers like Atlanta. On one hand, these community-driven areas where food vendors and retailers sell products side by side are secondary competitors to food trucks. But they also offer growth opportunities for future expansion as brands solidify customer support in the region. The most popular food halls in Atlanta are Ponce City Market in Midtown, Krog Street Market along the BeltLine trail in the Inman Park area, and Sweet Auburn Municipal Market downtown Atlanta. In addition to these trends, Atlanta has long been supportive of international cuisine as Buford Highway (nicknamed “BuHi”) has a reputation for being an eclectic food corridor with an abundance of renowned Asian and Hispanic restaurants in particular.

The Atlanta region is home to a thriving Hispanic and Latinx population, with nearly half of the region’s foreign-born population hailing from Latin America. There are over half a million Hispanic and Latin residents living in metro Atlanta, with a 150 percent population increase predicted through 2040. The median age of metro Atlanta Latinos is twenty-six. La Vida Lola will offer authentic cuisine that will appeal to this primary customer segment.

La Vida Lola must contend with regulations from towns concerning operations of mobile food ventures and health regulations, but the Atlanta region is generally supportive of such operations. There are many parks and festivals that include food truck vendors on a weekly basis.

Table 11.5

Competitive Analysis

The competitive analysis is a statement of the business strategy as it relates to the competition. You want to be able to identify who are your major competitors and assess what are their market shares, markets served, strategies employed, and expected response to entry? You likely want to conduct a classic **SWOT analysis** (Strengths Weaknesses Opportunities Threats) and complete a competitive-strength grid or competitive matrix. Outline your company's competitive strengths relative to those of the competition in regard to product, distribution, pricing, promotion, and advertising. What are your company's competitive advantages and their likely impacts on its success? The key is to construct it properly for the relevant features/benefits (by weight, according to customers) and how the startup compares to incumbents. The **competitive matrix** should show clearly how and why the startup has a clear (if not currently measurable) competitive advantage. Some common features in the example include price, benefits, quality, type of features, locations, and distribution/sales. Sample templates are shown in Figure 11.17 and Figure 11.18. A competitive analysis helps you create a marketing strategy that will identify assets or skills that your competitors are lacking so you can plan to fill those gaps, giving you a distinct competitive advantage. When creating a competitor analysis, it is important to focus on the key features and elements that matter to customers, rather than focusing too heavily on the entrepreneur's idea and desires.

	La Vida Lola	Mix'D Up Burgers	Mac the Cheese	The Fry Guy	The Blaxican
Price	$6-$13	$10	$10-13	$13+	High end
Location	Varies	Rotate/Smyrna	Rotates	Buckhead	Midtown
Quality	Mid to high	Low	Mid	High	High
Food type	Latin	American/ Burgers	American/ Comfort	American	Soul/ Mexican fusion

Figure 11.17 This chart shows one sample format for a competitor analysis. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

COMPETITIVE ANALYSIS TEMPLATE							
	Price	**Benefits**	**Quality**	**Features**	**Locations**	**Distribution/ Sales**	**Customer satisfaction**
Competitor 1							
Competitor 2							
Competitor 3							
Competitor 4							

Figure 11.18 This chart provides a more complex template for creating a competitive analysis. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Operations and Management Plan

In this section, outline how you will manage your company. Describe its organizational structure. Here you can address the form of ownership and, if warranted, include an organizational chart/structure. Highlight the backgrounds, experiences, qualifications, areas of expertise, and roles of members of the management team. This is also the place to mention any other stakeholders, such as a board of directors or advisory board(s), and their relevant relationship to the founder, experience and value to help make the venture successful, and professional service firms providing management support, such as accounting services and legal counsel.

Table 11.6 shows a sample operations and management plan for La Vida Lola.

Operations and Management Plan for La Vida Lola

Operations and Management Plan Category	Content
Key Management Personnel	The key management personnel consist of Lola González and Cameron Hamilton, who are longtime acquaintances since college. The management team will be responsible for funding the venture as well as securing loans to start the venture. The following is a summary of the key personnel backgrounds. *Lola González:* Chef Lola González has worked directly in the food service industry for fifteen years. While food has been a lifelong passion learned in her grandparents' kitchen, chef González has trained under some of the top chefs in the world, most recently having worked under the James Beard Award-winning chef José Andrés. A native of Duluth, Georgia, chef González also has an undergraduate degree in food and beverage management. Her value to the firm is serving as "the face" and company namesake, preparing the meals, creating cuisine concepts, and running the day-to-day operations of La Vida Lola. *Cameron Hamilton:* Cameron Hamilton has worked in the hospitality industry for over twenty years and is experienced in accounting and finance. He has a master of business administration degree and an undergraduate degree in hospitality and tourism management. He has opened and managed several successful business ventures in the hospitality industry. His value to the firm is in business operations, accounting, and finance.
Advisory Board	During the first year of operation, the company intends to keep a lean operation and does not plan to implement an advisory board. At the end of the first year of operation, the management team will conduct a thorough review and discuss the need for an advisory board.

Table 11.6

Operations and Management Plan for La Vida Lola

Operations and Management Plan Category	Content
Supporting Professionals	Stephen Ngo, Certified Professional Accountant (CPA), of Valdosta, Georgia, will provide accounting consulting services. Joanna Johnson, an attorney and friend of chef González, will provide recommendations regarding legal services and business formation.

Table 11.6

Marketing Plan

Here you should outline and describe an effective overall marketing strategy for your venture, providing details regarding pricing, promotion, advertising, distribution, media usage, public relations, and a digital presence. Fully describe your sales management plan and the composition of your sales force, along with a comprehensive and detailed budget for the marketing plan. Table 11.7 shows a sample marketing plan for La Vida Lola.

Marketing Plan for La Vida Lola

Marketing Plan Category	Content
Overview	La Vida Lola will adopt a concentrated marketing strategy. The company’s promotion mix will include a mix of advertising, sales promotion, public relations, and personal selling. Given the target millennial foodie audience, the majority of the promotion mix will be centered around social media platforms. Various social media content will be created in both Spanish and English. The company will also launch a crowdfunding campaign on two crowdfunding platforms for the dual purpose of promotion/publicity and fundraising.
Advertising and Sales Promotion	As with any crowdfunding social media marketing plan, the first place to begin is with the owners’ friends and family. Utilizing primarily Facebook/Instagram and Twitter, La Vida Lola will announce the crowdfunding initiative to their personal networks and prevail upon these friends and family to share the information. Meanwhile, La Vida Lola needs to

Table 11.7

Marketing Plan for La Vida Lola

<table>
<tr><th>Marketing Plan Category</th><th>Content</th></tr>
<tr><td></td><td>
focus on building a community of backers and cultivating the emotional draw of becoming part of the La Vida Lola family.
To build a crowdfunding community via social media, La Vida Lola will routinely share its location, daily if possible, on both Facebook, Instagram, and Twitter. Inviting and encouraging people to visit and sample their food can rouse interest in the cause. As the campaign is nearing its goal, it would be beneficial to offer a free food item to backers of a specific level, say $50, on one specific day. Sharing this via social media in the day or two preceding the giveaway and on the day of can encourage more backers to commit.
Weekly updates of the campaign and the project as a whole are a must. Facebook and Twitter updates of the project coupled with educational information sharing helps backers feel part of the La Vida Lola community.
Finally, at every location where La Vida Lola is serving its food, signage will notify the public of their social media presence and the current crowdfunding campaign. Each meal will be accompanied by an invitation from the server for the patron to visit the crowdfunding site and consider donating. Business cards listing the social media and crowdfunding information will be available in the most visible location, likely the counter.
Before moving forward with launching a crowdfunding campaign, La Vida Lola will create its website. The website is a great place to establish and share the La Vida Lola brand, vision, videos, menus, staff, and events. It is also a great source of information for potential backers who are unsure about donating to the crowdfunding campaigns. The website will include these elements:

About Us. Address the following questions: Who are you? What are the guiding principles of La Vida Lola? How did the business get started? How long has La Vida Lola been in business? Include pictures of chef González.
Menu. List of current offerings with prices.
Calendar of Events. Will include promotional events and locations where customers can find the truck for different events.
Social Media. Steps will be taken to increase social media followers prior to launching the crowdfunding campaign. Unless a large social media following is already established, a business should aggressively push social media campaigns a minimum of three months prior to the crowdfunding campaign launch. Increasing social media following prior to the campaign kickoff will also allow potential donors to learn more about La Vida Lola and foster relationship building before attempting to raise funds.

</td></tr>
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Table 11.7

Marketing Plan for La Vida Lola

Marketing Plan Category	Content
Facebook Content and Advertising	The key piece of content will be the campaign pitch video, reshared as a native Facebook upload. A link to the crowdfunding campaigns can be included in the caption. Sharing the same high-quality video published on the campaign page will entice fans to visit Kickstarter to learn more about the project and rewards available to backers. • Promoted Post(s): Boosting/promoting a Facebook post for only $5 can go a long way for a business page the size of La Vida Lola’s. Reach and engagement will be exponentially higher than it would have been organically. Promoting two or three posts during the first few weeks of the campaign would be highly effective. • Video Views Ad: Video ads are a little more ambitious than promoted posts and cost a little more. But the objective is the same: increase the number of people who watch the pitch video and drive them to the campaign page.
Crowdfunding Campaigns	Foodstart was created just for restaurants, breweries, cafés, food trucks, and other food businesses, and allows owners to raise money in small increments. It is similar to Indiegogo in that it offers both flexible and fixed funding models and charges a percentage for successful campaigns, which it claims to be the lowest of any crowdfunding platform. It uses a reward-based system rather than equity, where backers are offered rewards or perks resulting in “low-cost capital and a network of people who now have an incentive to see you succeed.”[54] Foodstart will host La Vida Lola’s crowdfunding campaigns for the following reasons: (1) It caters to their niche market; (2) it has less competition from other projects which means that La Vida Lola will stand out more and not get lost in the shuffle; and (3) it has/is making a name/brand for itself which means that more potential backers are aware of it. La Vida Lola will run a simultaneous crowdfunding campaign on Indiegogo, which has broader mass appeal.
Publicity	Social media can be a valuable marketing tool to draw people to the Foodstarter and Indiegogo crowdfunding pages. It provides a means to engage followers and keep funders/backers updated on current fundraising milestones. The first order of business is to increase La Vida Lola’s social media presence on Facebook, Instagram, and Twitter. Establishing and using a common hashtag such as #FundLola across all platforms will promote familiarity and searchability, especially within Instagram and Twitter. Hashtags

54 Foodstart. http://foodstart.com

Marketing Plan for La Vida Lola

<table>
<tr><th>Marketing Plan Category</th><th>Content</th></tr>
<tr><td></td><td> are slowly becoming a presence on Facebook. The hashtag will be used in all print collateral.
La Vida Lola will need to identify social influencers—others on social media who can assist with recruiting followers and sharing information. Existing followers, family, friends, local food providers, and noncompetitive surrounding establishments should be called upon to assist with sharing La Vida Lola’s brand, mission, and so on. Cross-promotion will further extend La Vida Lola’s social reach and engagement. Influencers can be called upon to cross promote upcoming events and specials.
The crowdfunding strategy will utilize a progressive reward-based model and establish a reward schedule such as the following:

$5 or more (unlimited): Exclusive updates on fundraising progress
$10 or more (500): $1 OFF; a coupon for $1 off purchase
$20 or more (200): BOGO! Buy one entree, get one FREE
$50 or more (100): FREE entrée coupon
$250 or more (2): One-on-one with chef González!

In addition to the publicity generated through social media channels and the crowdfunding campaign, La Vida Lola will reach out to area online and print publications (both English- and Spanish-language outlets) for feature articles. Articles are usually teased and/or shared via social media. Reaching out to local broadcast stations (radio and television) may provide opportunities as well. La Vida Lola will recruit a social media intern to assist with developing and implementing a social media content plan. Engaging with the audience and responding to all comments and feedback is important for the success of the campaign.
Some user personas from segmentation to target in the campaign:

Influencer Isabel: Social media-savvy, college-age Latina influencer
Food truck Freddie: An avid food truck follower, this thirty-three-year-old white urban hipster professional seeks out the best food trucks around town on a regular basis looking for “noms” to satisfy his cravings.
Taco townies: In-town residents who religiously eat tacos on “taco Tuesday,” as a family rite of passage for the wives, husbands, and kids. The entire neighborhood turns out for the occasion as a community event of sorts.
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Table 11.7

Financial Plan

A **financial plan** seeks to forecast revenue and expenses; project a financial narrative; and estimate project costs, valuations, and cash flow projections. This section should present an accurate, realistic, and achievable financial plan for your venture (see Entrepreneurial Finance and Accounting for detailed discussions about conducting these projections). Include sales forecasts and income projections, pro forma financial statements (Building the Entrepreneurial Dream Team, a breakeven analysis, and a capital budget. Identify your possible sources of financing (discussed in Conducting a Feasibility Analysis). Figure 11.19 shows a template of cash-flow needs for La Vida Lola.

INCOME		EXPENSES	
Daily Income		**Fixed Monthly Expenses**	
Monday	$	Facility rental	$
Tuesday	$	Personal loans	$
Wednesday	$	Insurance	$
Thursday	$	Credit cards	$
Friday	$	Farmer's Market overheads	$
Saturday AM	$	Planned savings	$
Saturday PM	$	Other	$
Sunday	$	*Total fixed monthly expenses*	$
		Variable Monthly Expenses	
		Food/Beverages	$
		Utilities (electricity, gas)	$
		Uniforms	$
		Wages	$
		Fuel (vehicle)	$
		Medical expenses	$
		Other	$
		Total variable monthly expenses	$
		Fixed Infrequent Expenses	
		Insurance	$
		Annual subscriptions	$
		Property rates/taxes	$
		Union fees	$
		Education	$
		Other	$
		Total fixed infrequent expenses	$
		Variable Infrequent Expenses	
		Gifts	$
		Holidays	$
		Vehicle repairs and registration	$
		Durable goods purchase	$
		Donations	$
		Other	$
		Total variable infrequent expenses	$
TOTAL Income	**$**	**TOTAL Expenses**	$
		DIFFERENCE = Income available	**$**

Figure 11.19 La Vida Lola can use a template like this to project cash flow. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

ENTREPRENEUR IN ACTION

Laughing Man Coffee

Hugh Jackman (Figure 11.20) may best be known for portraying a comic-book superhero who used his mutant abilities to protect the world from villains. But the *Wolverine* actor is also working to make the planet a better place for real, not through adamantium claws but through social entrepreneurship.

Figure 11.20 Hugh Jackman launched a social entrepreneurship venture called Laughing Man Coffee. (credit: “Hugh Jackman navy” by “U.S. Navy photo by Photographer's Mate Airman Dennard Vinson”/Wikimedia Commons, Public Domain)

A love of java jolted Jackman into action in 2009, when he traveled to Ethiopia with a Christian humanitarian group to shoot a documentary about the impact of fair-trade certification on coffee growers there. He decided to launch a business and follow in the footsteps of the late Paul Newman, another famous actor turned philanthropist via food ventures.

Jackman launched Laughing Man Coffee two years later; he sold the line to Keurig in 2015. One Laughing Man Coffee café in New York continues to operate independently, investing its proceeds into charitable programs that support better housing, health, and educational initiatives within fair-trade farming communities.[55] Although the New York location is the only café, the coffee brand is still distributed, with Keurig donating an undisclosed portion of Laughing Man proceeds to those causes (whereas Jackman donates all his profits). The company initially donated its profits to World Vision, the Christian humanitarian group Jackman accompanied in 2009. In 2017, it created the Laughing Man Foundation to be more active with its money management and distribution.

- You be the entrepreneur. If you were Jackman, would you have sold the company to Keurig? Why or why not?

- Would you have started the Laughing Man Foundation?
- What else can Jackman do to aid fair-trade practices for coffee growers?

WHAT CAN YOU DO?

Textbooks for Change

Founded in 2014, Textbooks for Change uses a cross-compensation model, in which one customer segment pays for a product or service, and the profit from that revenue is used to provide the same product or service to another, underserved segment. Textbooks for Change partners with student organizations to collect used college textbooks, some of which are re-sold while others are donated to students in need at underserved universities across the globe. The organization has reused or recycled 250,000 textbooks, providing 220,000 students with access through seven campus partners in East Africa. This B-corp social enterprise tackles a problem and offers a solution that is directly relevant to college students like yourself. Have you observed a problem on your college campus or other campuses that is not being served properly? Could it result in a social enterprise?

WORK IT OUT

Franchisee Set Out

A franchisee of East Coast Wings, a chain with dozens of restaurants in the United States, has decided to part ways with the chain. The new store will feature the same basic sports-bar-and-restaurant concept and serve the same basic foods: chicken wings, burgers, sandwiches, and the like. The new restaurant can't rely on the same distributors and suppliers. A new business plan is needed.

- What steps should the new restaurant take to create a new business plan?
- Should it attempt to serve the same customers? Why or why not?

LINK TO LEARNING

This New York Times video, "An Unlikely Business Plan," describes entrepreneurial resurgence (https://openstax.org/l/52EntreResurg) in Detroit, Michigan.

55 "Hugh Jackman Journey to Starting a Social Enterprise Coffee Company." Giving Compass. April 8, 2018. https://givingcompass.org/article/hugh-jackman-journey-to-starting-a-social-enterprise-coffee-company/

Key Terms

balance sheet financial statement that summarizes a company's financial condition according to the accounting equation

breakeven point level of operations that results in exactly enough revenue to cover costs

business model plan for how venture will be funded; how the venture creates value for its stakeholders, including customers; how the venture's offerings are made and distributed to the end users; and the how income will be generated through this process

business model canvas developed by Osterwalder and Pigneur, used to develop a business model for a venture, including nine blocks that are mapped out to address customer segments, customer relationships, channels, revenue streams, value propositions, key partners, key activities, key resources, and cost structure

business model innovation occurs when an existing business fundamentally changes their business model

business plan formal document that typically describes the business and industry, market strategies, sales potential, and competitive analysis, as well as the company's long-term goals and objectives

competitive matrix shows how and why a startup has a clear if not measurable competitive advantage for relevant features/benefits by weight according to customers, such as price and quality in relation to competitors

customer empathy map portrayal of a target customer, the most promising candidate from a business' customer segments, which explores the understanding of that person's condition from their perspective to understand his or her problems and needs

disruptive innovation process that significantly impacts the market by making a product or service more affordable and/or accessible often by smaller companies in an industry

executive summary initial section of a business plan document that summarizes the key elements of the entire plan

feasibility analysis feasibility analysis is the process of determining if a business idea is viable; it includes testing the viability of your product or service, evaluating your management team, assessing the market for your concept, and estimating financial viability

financial analysis forecasts revenue and expenses; projects a financial narrative; and estimates project costs, valuations, and cash flow projections

fixed costs costs that do not change, regardless of the amount of sales

go-or-no-go decision determination to proceed with or abandon a plan or project

innovation new idea, process, or product, or a change to an existing product or process

lean model canvas developed by Ash Maurya as a derivation of the original business model canvas; this canvas differs by addressing unfair advantages, problems, solutions, and key metrics rather than customer relationships, key partners, key activities, and key resources

market analysis analysis of the overall interest in the product or service within the industry by its target market

projected cash flow outline of preliminary expenses, operating expenses, and reserves

serviceable available market (SAM) portion of the market that a business can serve based on its products, services, and location

social business model canvas modification of the business model canvas, designed for social entrepreneurship venues; new areas address impact measures around social impacts and its measurement, surplus, beneficiary segments and social and customer value propositions

SWOT analysis strategic analytical tool used to help a potential venture or existing company identify its strengths, weaknesses, opportunities, and threats related to business competition

total available market (TAM) total perceived demand for a product or service within the marketplace

value proposition summary describing the benefits (value) customers can expect from a particular product or service

value proposition canvas one of the nine blocks on the business model canvas, this additional tool developed by Osterwalder and Pigneur is designed to illustrate a deeper dive into customer understanding and value creation of a business

variable costs costs that fluctuate with the level of revenue

Summary

11.1 Avoiding the “Field of Dreams” Approach

Business models and business plans are tools involved in the strategic process of charting a path for your entrepreneurial venture. When starting a company, it’s best to avoid the *Field of Dreams* approach of building a business and hoping that customers will just show up. Innovation has been linked to entrepreneurship for at least nine decades. More recent theories suggest that disruptive innovations are disruptive because they disturb the underlying business model of the companies being disrupted.

11.2 Designing the Business Model

A business model, which is unique to a company, describes the rationale of how an organization creates, delivers, and captures values. A business model canvas is a popular tool used by entrepreneurs and intrapraneurs to map out and plan different components of a business model. The business model canvas addresses customer segments, customer relationships, channels (of distribution), revenue streams, value propositions, key partners, key activities, key resources, and cost structure. The lean model canvas and social business model canvas are derivations of the original business model canvas. They are designed more for tech/software/app endeavors and social entrepreneurial ventures, respectively.

11.3 Conducting a Feasibility Analysis

A feasibility study is a tool in the entrepreneurs’ toolkit that can help determine whether to proceed on a venture early on. A feasibility study is usually more in depth than a business plan and focuses on analysis of real-world numbers and projections. The most common elements of a feasibility study include a market analysis, a financial analysis, and management analysis. Feasibility studies can be used to make a “go-or-no-go” decision for a new product or business, as well as help narrow the focus of what that venture should be (what the market would potentially support).

11.4 The Business Plan

The business plan is a formal document used for long-range planning of a company’s operation that typically includes financial information, background information, and a summary of the business. Business plans can be used as internal guiding documents early in the entrepreneurial process. They also can be presentation documents for raising funds from prospective investors later in the process, complementing an investor pitch and iterative canvases. A brief business plan functions somewhat like an extended executive summary that summarizes key elements of the entire business plan, such as the business concept, financial features, and current business position. A full business plan can range from ten to twenty-five pages. It includes a business description, industry and marketing analyses, and descriptions of management, marketing, and operational and financial plans.

Review Questions

1. According to Ash Maurya's typology, Airbnb is an example of what type of business model?

A. direct
B. multisided
C. open
D. marketplace

2. Which startup grew from a failed podcasting company called Odeo?

A. Instagram
B. Twitter
C. StubHub
D. Groupon

3. What is the job to be done of a milkshake according to Christensen's team's customer observation research in the Link to Learning video: https://www.youtube.com/watch?v=m3mVM_koAio&feature=youtu.be?

A. employ Chick-Fil-A cows
B. accompany on a long morning commute
C. placate children
D. satisfy hunger

4. What is a change, typically minor, of the current business model in an attempt to capitalize on a closely related market opportunity?

A. innovation
B. disruption
C. iteration
D. increment

5. A tool to identify your idealized target customer and develop a better understanding of his or her environment, behavior, concerns, and aspirations.

A. jobs to be done
B. business plan
C. business model canvas
D. empathy map

6. A _______ is a formal document that typically describes the business and industry, market strategies, sales potential, and competitive analysis, as well as the company's long-term goals and objectives.

A. business plan
B. business model
C. customer empathy map
D. revenue model

7. Select the item that does not belong to the business model canvas.

A. market size
B. revenue streams
C. value proposition
D. customer segments

8. The finished story benefit formula of [end customer wants] + [specific period of time] + [address objections] is designed for what component of the lean model canvas?

A. unfair advantage
B. unique value proposition
C. early adopters
D. high concept pitch

9. How does the social business model canvas differ from the business model canvas and lean model canvas?

A. is only used by nonprofit company
B. doesn’t have customer block and investment block
C. has profit block to talk about ways the company can makes more money
D. has impact measure, surplus, beneficiary segments, and social and customer value propositions

10. Which of the following has the purpose of evaluating the team, the market for the concept, the financial viability, and possible pitfalls?

A. feasibility analysis
B. market analysis
C. financial analysis
D. management analysis

11. Which of the following has the purpose of forecasting revenue and expenses, projecting a financial narrative, estimating project cost, and projecting cash flow?

A. feasibility analysis
B. market analysis
C. financial analysis
D. management analysis

12. Which of the following identifies competitors and quantifies target customers and/or users in a specific industry?

A. feasibility analysis
B. market analysis
C. financial analysis
D. management analysis

13. What assesses the prowess of the management and sufficiency of resources to bring the product or idea to market?

A. management analysis
B. operational feasibility analysis
C. financial analysis
D. cash flow

14. What are expenses that do not vary with the level of sales, such as rent, salaries, utilities, insurance and other operating expenses?

A. fixed costs
B. variable costs
C. balance sheet
D. cash flow statements

15. Which of the following is a formal document that typically describes the business and industry, market strategies, sales potential, and competitive analysis, as well as the company's long-term goals and objectives?

A. business plan
B. business model
C. customer empathy map
D. revenue model

16. Which of these is not the purpose of a business plan?

A. thoroughly explain a business idea and how it will be carried out
B. planning tool and working plan over the course of several years
C. requirement to start a business
D. planning for "what-if" scenarios and explore new options

17. Which of these components are not in a business plan?

A. business description
B. industry and market analysis
C. financial analysis
D. None of these options is correct.

18. Estimated profits and expenses of the business is included in which of the following?

A. financial analysis
B. industry and market analysis
C. operation plan
D. marketing plan

19. Who is best suited to write a business plan?

A. investor
B. founder(s)
C. consultant
D. chief financial officer

Discussion Questions

1. What role do customers play in innovation? Is innovation possible without customer support?

2. Do you believe that teamwork is important to entrepreneurship? Or do you prefer solopreneurship? Is one approach "better" than the other? Why or why not?

3. What are the advantages of using a canvas to plan your business?

4. What types of businesses fit best with each respective canvas type?

5. Why would impact measures be important in social entrepreneurship ventures?

6. How do the arts relate to the business model creation process?

7. What are the advantages of using a lean model canvas compared to the traditional business model canvas?

8. What components are in the breakeven analysis? How would you calculate your breakeven point?

9. Why is feasibility analysis important?

10. What are the different components of a feasibility analysis?

11. Explain the purpose and importance of business plan.

12. Describe the components of a business plan.

13. Should you write a business plan even if you do not need outside financing? Why or why not?

Case Questions

1. The National Association of Broadcasters launched its PILOT Innovation Challenge in 2016. The challenge is centered around a specific challenge question aimed at helping the association's primary customers, broadcasters. The most recent challenge question was, "What is an unconventional way broadcasters and other local media could serve communities?" The PILOT organizers have contracted you to help them design their next challenge. Using your knowledge of innovation and customer-centric entrepreneurship processes, what would you advise? How would you go about determining the challenge question? What questions about innovation would you have regarding the Innovation Challenge?

2. The Guidewell Innovation Center at Lake Nona Medical Center on the outskirts of Orlando, Florida, is a 92,000-square-foot facility aimed at accelerating innovation within the healthcare industries. Guidewell, the parent company of Florida Blue, brings in outside companies to help with that innovation process. One of the features of the Innovation Center is its Collaborative Resource Ecosystem. Some of the center's strategic areas of focus are next-generation consumer engagement, computational health, well-being and human performance, digital health, and remote management, among other areas. How could Christensen's theory of disruptive innovation and jobs-to-be-done theory help guide Guidewell's mission? What are the prevalent business models in the strategic areas for incumbent businesses? What are opportunities for innovation for new companies?

3. As youth programs face severe budget cuts, many youth sports organizations respond by raising their fees, which shifts the costs to families. Good Sports was founded in 2003, to tackle this problem by providing new equipment, footwear, and apparel to those most in need. The organization's addressable markets include children ages five to eighteen living in low-income households, as defined by poverty data, and participating in youth sports in top fifty metropolitan service areas. This Boston-based organization has plans to expand from its three existing markets in Dallas, Chicago, and Boston to seven total markets by 2023 with a goal to serve 600,000 kids by that target date.

A. What would a customer empathy map look like for Good Sports' target user? What about its target customer segment? Would it or should it differ in differing markets? Is the Boston area user any different from say, an Atlanta, user?

B. Given its social mission, what are some impact measures Good Sports could use to gauge success and impact?

4. DoSomething.Org is a “global movement for good” among 6 million young people, transforming their communities across the United States and in 131 countries worldwide. This nonprofit organization constantly holds cause-based campaigns, ranging from receiving over 1 million pairs of donated jeans from teens to clothe homeless youth to cleaning up 3.7 million cigarette butts through its Get the Filter Out initiative. A past campaign, “Don’t Be a Sucker,” addressed the problem of Americans losing $5.8 billion annually and producing 8.7 billion pounds of carbon pollution by leaving unused devices plugged in. The campaign sought to slay those “energy vampires” not in use by having users unplug equipment and post a sticky note next to the outlet to remind others not to let them suck the energy dry. Further research the problem, solution and this campaign and answer the following:

A. Identify what social impact(s) the campaign addressed.
B. What impact measures could the campaign assess?
C. Could a viable business be created around this problem?

5. In recent years, the entrepreneurial educator and author Steve Blank began applying lean startup principles to various US governmental agencies. Through a Hacking for Diplomacy course, students at Stanford University began tackling problems for the Department of State. A former US ambassador to the United Nations, a State Department representative to Silicon Valley and senior advisor for technology and innovation, a retired US Army colonel, and other entrepreneurial educators joined Blank in applying lean startup methods to State Department issues. Then-Secretary of State John Kerry even visited the Stanford students and said he was looking forward to the solutions students develop during the ten weeks. One project that emerged was from a group calling themselves Team Space Evaders. The team was tasked with working on the problem of satellite collision. Members charted satellite positioning data and explored how information about potential collision was shared by commercial operators and governmental entities ranging from the Federal Aviation Administration to the Department of Defense.

A. Apply the lean startup methodology to identify potential customer segments and problems and solutions that students such as yourself could identify for the State Department on the issue of satellite collision.
B. What would a unique value proposition for a State Department solution to this issue be? How could a high-level concept pitch work when selling the concept within the State Department?

6. Incorporated in 2003, Tesla declared in its mission statement that its goal is “to accelerate the world’s transition to sustainable transport,”[56] and it has proven itself a leader in green technology in the automotive sector. In its initial business plan, by co-founder Martin Eberhard, the electric sports car company promised to provide the value of a high-end sports car at a lower cost to the customer and a lower environmental cost to the planet. Electric vehicles were seen as inferior to standard vehicles prior to Tesla’s innovations in creating powerful cars that piqued consumer desire. The generic automotive manufacturing business model relies on collaborative manufacturing with industry partners and a distribution model dependent on third parties. Standard cars are aimed at people and businesses with individual transportation needs. This model is commercially viable because of custom-equipped add-on features to the per-vehicle prices.

A. Tesla’s business model is different. Identify at least three ways in which the Tesla model differs from the traditional automotive business model.

56 In 2016, it was changed from “sustainable transport” to “sustainable energy.” https://www.tesla.com/about

7. In the mid-1990s, at least one newspaper company, the now-defunct Knight-Ridder chain, created the prototype for a tablet newspaper that very much resembles the present-day iPad. A 1994 video titled “The Tablet Newspaper: A Vision for the Future” shows off the design of a futuristic newspaper designed at the Knight Ridder Information Design Lab in Boulder, Colorado. The video went viral in 2011 after it was posted on YouTube and numerous websites and blogs. The person behind the tablet vision, Roger Fidler, had even published an essay describing a tablet future as far back as 1981. The Knight-Ridder lab shared a wall with its neighbor Apple, with executives swapping ideas and visitors. The newspaper company, focused on content creation and not the hardware side, decided to not patent its tablet design and scrapped the project because screens took too much energy, and it was too expensive.

A. Using the components of a feasibility study, consider how the newspaper company would stack up on go-or-no-go decisions for each component of the feasibility study.
B. How did the newspaper company in the 1990s fare in terms of management prowess, resource capabilities, financial viability, and market analysis?
C. Do you think the newspaper made a wise decision to abandon the project when it did? Why or why not?

8. Founded in 2013 primarily as a coding boot camp, Tech Talent South offers both part-time and full-time courses on topics like Ruby on Rails and Big Data Analytics. Most of the camp’s programs are run out of cooperative working spaces and temporary locations throughout the cities it has a presence in. The primary focus of the Atlanta-founded and now North Carolina-based company as branded in the name was on coding in the South, but the company to date has expanded to eleven markets with plans to expand even more. The founder, Betsy Idilbi, jokes that she wouldn’t have named the company Tech Talent South if she had known its full potential and growth, including being plugged into the entrepreneurial ecosystem in places such as Columbus, Ohio. The company even has offices in the northeastern city of Hartford, Connecticut.

A. Could a feasibility analysis have helped Betsy from the start?
B. The company has expanded its business to offer corporate trainings at existing companies, rather than teaching classes directly to student enrollees. How would you identify a new potential market for Tech Talent South to enter?
C. What could be done with its existing business?
D. How would you advise the company on making go-or-no-go decisions for entering new markets?

9. You were introduced to The Cut Buddy, a plastic hair and beard grooming tool that began selling on Amazon in 2016, in The Business Plan. Following funding from the *Shark Tank* investor Daymond John, the company plans to expand into retail and extend its product line.

A. How would a business plan for the company’s ecommerce business differ from a retail distribution outlet?
B. Discuss how changes to aspects of the original business plan affected the outcome of the success of The Cut Buddy.
C. What do you think should be the key markets and strategies moving forward for the company?

10. Pretty Young Professional, discussed in The Business Plan, failed because of disagreements among its four founders that emerged shortly after launch.

A. If you were to launch the venture today, outline what steps you would need to take in formulating a business plan.
B. What do you think the total addressable market would be, which industry classification would it fall under, and who would be the primary competition?

Suggested Resources

11.2 Designing the Business Model

Business model canvas and resources: Strategyzer.com

Lean canvas and associated resources: Leanstack.com

Social business model canvas and related resources: Socialbusinessmodelcanvas.com

Christopher Steiner and Brett Nelson. “The 20 Most Important Questions in Business.” *Forbes*. June 17, 2010: https://www.forbes.com/2010/06/17/most-important-questions-in-business-entrepreneurs-management-small-business.html#7975585a3e93

11.3 Conducting a Feasibility Analysis

Bruce Barringer, *Preparing Effective Business Plans: An Entrepreneurial Approach*, 2nd ed. (Upper Saddle River, NJ: Pearson, 2015).

https://bizfluent.com/how-8048004-prepare-financial-feasibility-study.html

https://thebusinessprofessor.com/knowledge-base/financial-analysis-of-business-idea-overview/

11.4 The Business Plan

SBA Business Plan resources: https://www.sba.gov/business-guide/plan-your-business/write-your-business-plan

12

Building Networks and Foundations

Figure 12.1 US 1 is the route into and out of the Florida Keys that residents and visitors alike take to their intended destinations. But more importantly, US 1, a physical structure of steel-reinforced concrete, is the artery through which economic exchanges are created and enhanced. (credit: modification of "Seven mile bridge" by Tinsley Advertising/Wikimedia Commons, CC BY)

Chapter Outline

Introduction

US Route 1 in southern Florida connects 43 islands of the Florida Keys via 42 bridges. It is a bidirectional economic path from the US mainland to its endpoint at Key West and for all points in between. Without the bridges it provides, residents, workers, and tourists would be required to ferry to their destinations, sacrificing time, money, economic efficiency, market productivity, and recreation. The bridges ensure an unimpeded flow of economic activities that benefit residents and visitors, increasing tourism across the entire state, and ensuring Key West is not economically and socially isolated.

Every entrepreneur can learn a few lessons from US 1. First, independent market players are stronger and more stable when connected to other independent market players. Second, connections are not always easy to establish. The idea of connecting all of the keys met resistance, and engineers had to solve many challenges. Third, you must be prepared to repair connections whenever they are severed. A hurricane destroyed the original railroad that connected the islands, but replacing it with an automobile highway was a major improvement. Other lessons are that benefits should outweigh costs, and that it takes time to build new connections: The original railroad took seven years to build. Costs of ongoing repair and maintenance have exceeded $1.8 billion[1] (adjusted for inflation) but produced $2.7 billion in annual economic activity for 2017.[2]

Today, no one in Florida would dream of doing without the highway.

How are businesses similar to Key West? Every business includes people who produce goods and services for customers to purchase. In turn, businesses and those who work for them need to consume the products and services provided by their own vendors. Finding and establishing relationships with vendors and customers, in addition to the support of community organizations and educational resources, facilitates the exchange of information, products, and services. The connection between a business and its vendors or its customers makes up a network.

12.1 Building and Connecting to Networks

Learning Objectives

By the end of this section, you will be able to:

- Define networking and describe its role in entrepreneurship
- Describe networking opportunities
- Describe local and trade organization networking opportunities
- Identify nonprofit and governmental agencies offering networking opportunities

When you begin thinking about your new and exciting entrepreneurial venture, you may feel somewhat like the citizens of Key West did many years ago—isolated. No matter which way you turn, you eventually come to the end of your limited community, and what you have is not enough. You can either sit on the beach and dream about what could be or commence working on building personal and professional connections to broaden your scope and improve the depth of relationships with those individuals who will assist you in becoming a successful entrepreneur. Now is the time to start building bridges and connecting yourself with the greater business community. Networking is about building bridges not about collecting tolls.

ENTREPRENEUR IN ACTION

Colonel Sanders and Building Connections

Harland David Sanders, the founder of Kentucky Fried Chicken (KFC), was a successful entrepreneur who personally experienced and understood the value of roadways and customer access. Sanders, better known as "Colonel" Sanders, owned a successful Shell service station with a small restaurant. He perfected his recipe for fried chicken and added it to his menu. Demand from satisfied customers soon exceeded seating capacity. To increase customer capacity, he purchased a building across the street that had a larger seating area. Business was steady and profitable until the new interstate system bypassed his location. Sanders lost his connection to his customers and closed his business. He did not give up, however.

Sanders began scouring the country for restaurants that would buy his recipe in exchange for $0.04 per piece of chicken sold. He reestablished a connection with an acquaintance in Salt Lake City, Utah, who

1 Alice Hopkins. "The Development of the Overseas Highway." *Tequesta: The Journal of the Historical Association of Southern Florida* 46 (1986): 48–58. http://digitalcollections.fiu.edu/tequesta/files/1986/86_1.pdf

2 Chris Mooney. "The Race to Save Florida's Devasted Coral Reef from Global Warming." *Washington Post*. June 25, 2017. https://www.washingtonpost.com/classic-apps/the-race-to-save-floridas-devastated-coral-reefs-from-global-warming/2017/06/25/a1bd899a-3fa9-11e7-adba-394ee67a7582_story.html

became the first KFC franchisee. With immediate success in Utah, Sanders began a nationwide campaign to connect with other successful restaurants and signed them on as franchisees. Eventually, Sanders formed a network of restaurants across the country that sold his chicken and grew a market that could never have been developed by one person in one location. In 2019, KFC had over 21,000 locations in 130 countries (www.kfc.com/about).

Sanders took his personal experience of losing easy customer access to his business and applied it to building a network of franchises where customers, across the United States and on multiple continents, could purchase his chicken. Just as tourists, residents, and businesses in Key West need roads and bridges to connect them to their destinations and suppliers, entrepreneurs need connections and networks to get supplies from their vendors and products to their customers.

For an entrepreneur, **networking** is finding and establishing relationships with business professionals with whom you can exchange information, ideas, and products; more importantly, you can claim these networks as trusted business colleagues. Be ready to use the networks you already have. Be intentional in seeking out established business professionals in your local chamber of commerce or at SCORE (see the following). Position yourself to contribute to the larger community. Be active in expanding your sphere of influence.

A good way to get started is to begin brainstorming a list of people who can help you along the entrepreneurial path. These potential trusted advisors will be beneficial to you as you develop your idea and start your business. In these early stages, you will encounter challenges and obstacles in many areas. Having a "go-to" list of dependable consultants can help you find solutions, reduce mistakes, and hasten your success in your new business. Anyone can be on that list—don't exclude anyone, no matter how unlikely it seems that you will need their expertise. People you already know have knowledge and skills. They can be a valuable resource.

On the other hand, you too have knowledge and skills. You too can be a valuable resource. That is why you are starting your own business or developing a new product. Begin connecting with people who need you, perhaps even people who need you more than you currently need them. Present yourself as the expert, not the salesperson to be avoided at all costs. Become known as the "go-to" person: the person others will seek out and put on their list of experts. When you become respected as the professional expert, success will follow.

We begin developing personal connections—relationships with other people—early in our lives. (Later in life, these connections become our networks.) Typically, the first social groups we join are family, neighbors, and schoolmates. Playing with siblings and cousins, and learning to meet new friends in the neighborhood and at elementary school help us develop the social skills that we will need later in life when we meet and work with others in the professional world. As you enter adulthood, social connections that you establish and nurture become more complex and have longer-lasting benefits. You may establish some of those lifelong personal connections during your college years or perhaps in your first "big" job.

Campus Connections

During your college years, you will have many opportunities to make connections with new people. Taking advantage of these opportunities allows you to perfect your skills in initiating and developing new and even lifetime connections. You can establish new friendships with roommates, classmates, social club members, special interest groups, academic organizations, competitive and intramural athletic teams, and many others. All of these groups not only encourage new social relationships but also foster opportunities for developing and improving leadership skills.

Chances to meet and work with new people abound on college campuses. The diagram in Figure 12.2 shows some of the many social networking opportunities on college campuses.

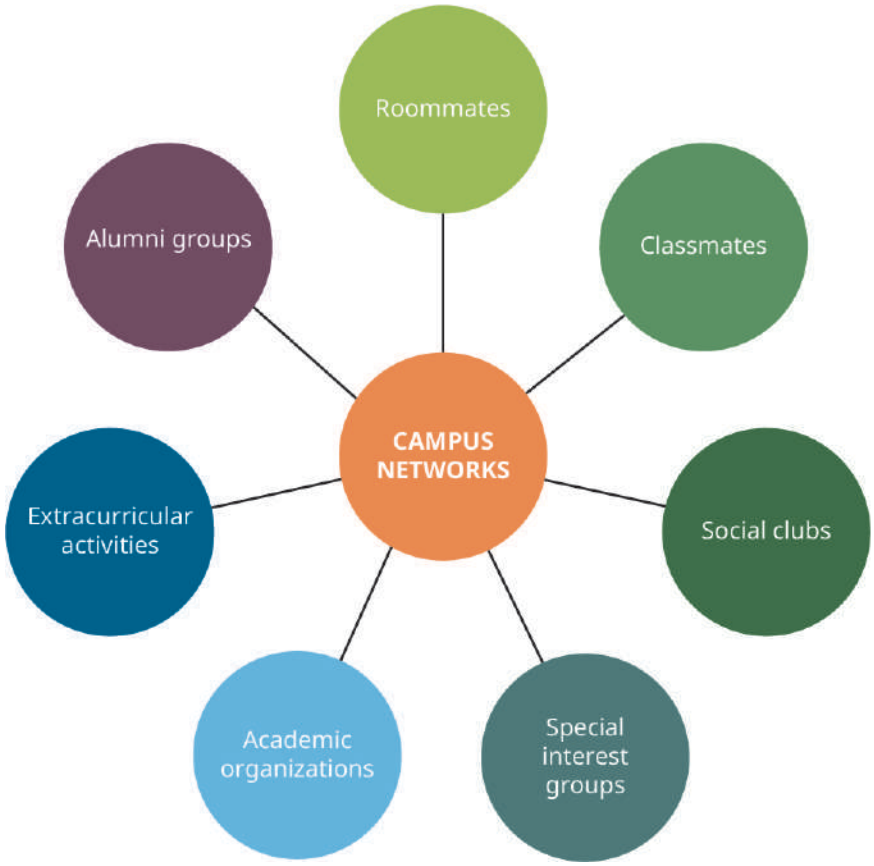

Figure 12.2 You can find many social networking opportunities through your college or university. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Your college or university is usually where you make the transition from student to professional. One method of learning to become a professional is through membership and leadership roles in academic or professional clubs. Leadership positions usually rotate annually. Academic clubs are formed around disciplines, departments, or professions. Professors, alumni, or industry professionals serve as sponsors and may provide connections to other industry professionals. Members learn the value of being active participants, discussing relevant topics. Fundraising or other special activities provide opportunities for developing leadership and organizational skills. Friendships and personal connections made in an academic club may become lifelong professional connections.

Honor societies are another type of academically oriented group, established to recognize the outstanding academic performance of students who have achieved a specific grade point average. Membership in an honor society brings with it the prestige of membership, opportunities for leadership roles, and access to professionals in many industries. Some honor societies offer scholarships for future studies in graduate school or study-abroad programs, which introduce members to students from other universities and countries with similar backgrounds and interests. Some honor societies open doors to conference memberships and presentations, and important access to other industry professionals.

Another type of collegiate organization is the special interest group. These groups may focus on social causes, promote and advance interests in the arts or other hobbies, or encourage participation in political, religious, or athletic events. Students from all disciplines and social backgrounds join special interest clubs. With such a broad spectrum of members, you have the opportunity to learn from many people from multiple backgrounds, expand your self-development, learn how to work with people who have different viewpoints, and potentially establish firm personal relationships.

Some clubs offer members the opportunity to perform or showcase their talent in a more relaxed and supportive atmosphere, or are centered around a personal interest. For example, a drama club for students not majoring in theater can offer a forum for participating in musicals and plays without the rigor demanded by the more structured academic program. Other groups that bring in nonacademic members include choral groups, visual arts gatherings, astronomy clubs, and gaming societies. These groups provide opportunities for the maturation and perfection of the interpersonal skills you need for success in the professional world. You can develop key interpersonal attributes among friends and colleagues while enjoying a common activity or interest.

Social clubs—sororities for women and fraternities for men—provide other opportunities to expand your circle of friends, as these organizations focus on social activities. Although many social clubs concentrate strictly on “get-together” activities, you can learn and perfect acceptable public-protocol behaviors at formal events as well as mastering skills in organizational negotiations and compromise. A few colleges and universities are beginning to formalize clubs for online students, including access to and membership in campus-based Greek life. One of the first online Greek clubs is Theta Omega Gamma, founded in 2009 at the Florida Institute of Technology.

College groups have high turnover rates in their membership and involvement. This can make it easier for you to learn and perfect the skills necessary for establishing social and professional connections through constant repetition of introducing yourself to new people, learning their backgrounds, and describing your own. Learning how to introduce yourself and become acquainted with strangers is a soft skill that you can learn more easily early in life than in later years, and knowing how to develop a personal relationship with others will benefit you for many years to come. One unintended benefit is that mistakes can be quickly forgotten. If you make a social blunder one semester, many in the group will soon forget your faux pas, and new members will never be aware of it.

Perhaps the largest university club is one whose membership extends beyond graduation—the alumni association. Membership in alumni associations is higher among students who earned an undergraduate degree than among those with a graduate degree. Furthermore, members of the alumni association are more dedicated and loyal to their alma mater than nonmembers. Because of their commitment to past and current students, members of alumni associations have an automatic connection to other members. Loyalty is an important characteristic of active members of the alumni association, so bonding with them links you to established professionals who can help you in your new business. One way to connect with alumni is through LinkedIn, a social network of business professionals.

The campus setting—either traditional or virtual—is one of the earliest multifaceted environments to which you as a young adult will belong. Learning how to maneuver on the college campus and within the parameters of university culture prepares you for your future environment.

Nontraditional and virtual students also can benefit from their college campus experience. These students come from a variety of industry and professional backgrounds, and they are exposed to diverse operational methods and strategies during class activities or assignments. Furthermore, becoming personally acquainted with project team members opens opportunities for building connections that might be professionally beneficial in the future.

Institutions of higher learning have become fundamentally self-contained communities. Each one functions almost like a small city, with students mingling throughout the day with people at all stages of life, from multiple backgrounds, and in various roles. It is a great place to start building a foundation of personal contacts or enhancing your current portfolio of contacts before entering a competitive world.

ARE YOU READY?

What I Need and Who I Know

Create a table with two columns. On the left, list questions or issues associated with starting a new business, such as: How much money do I need to start? What licenses should I get? Do I lease or buy? Where do I find customers? Where do I find employees? How does payroll work? What kind of insurance should I get?

On the right side, write down specific answers that you already know. For questions and issues that you can't answer, write down the name of a person you could ask to help answer that issue. If you do not know someone, who might help you get to the person who can give you an answer?

Local Organizations

Every community includes groups of individuals who have something in common. People group themselves together around shared beliefs, objectives, responsibilities, goals, or situations. Joining a local organization can place thousands of potential connections within your reach. Before seeking acceptance into a specific group, consider the type of group that fits your own personal and professional goals, and what you can contribute to the group's continuity.

An **open group** has a fluid membership; people may freely join or separate at any given time. Open groups tend to be informal, operate around a loose structure, and frequently focus on a personal or social cause. Open-membership groups include activities-oriented groups such as bridge clubs, scrapbooking groups, or photography clubs. Some open groups, such as Mothers Against Drunk Drivers (MADD) or People for the Ethical Treatment of Animals (PETA), focus on a specific topic or cause.

A **closed group** typically has either formal or informal criteria that you must meet before you can become a full member. Some organizations require sponsorship by a current member. Examples of closed groups include religious organizations, homeowners' or renters' associations, community performing arts groups, or sports groups.

Some community groups have features common to both open and closed groups. These **hybrid groups** have barriers or criteria that you must meet prior to joining, but those barriers are low, and prospective members can easily meet the criteria. Frequently, low barriers are an administrative feature to distinguish between participants who are serious about the group's activities and those who have an impulsive interest with no long-term commitment to the cause. Table 12.1 shows the differences among open, closed, and hybrid groups.

Open, Closed, and Hybrid Groups

Open Groups	Closed Groups	Hybrid Groups
• Fluid membership • Loosely structured, informal • May focus on personal/ social cause	• Membership criteria/ process • Structured • Formal purpose	• Low barriers to membership • Maintain barriers to ensure members are serious

Table 12.1

Groups that have a formal legal structure, an oversight board, and a professional management staff are more effective than those groups that are impulsively formed around a good idea. Professionally organized groups have skilled employees who set long-term goals and handle day-to-day activities. With the increase in structure and management, costs increase. To cover employee wages and benefits along with operational expenses of the group, many professional groups have membership dues and revenue-generating activities that members are expected to participate in. Some professional groups are self-supporting, whereas others are joint efforts among local and regional governments, universities, and the private sector.

One of the most successful private-public partnerships is the chamber of commerce arrangement. Local business entities establish a chamber of commerce organization to enhance the local community while expanding their own businesses. In some instances, the local government provides some type of monetary support for the chamber, but the chamber is neither an agency nor a function of government. For major community events, business members of a local chamber of commerce may provide their employees as volunteer staff who use their professional skills to organize and plan the event's activities. The community benefits, because a professionally managed event is held with minimal labor costs. The company receives publicity and exposure to potential customers within the local community at nominal costs. A close working partnership between the local chamber of commerce and government can produce outcomes that are mutually beneficial to local businesses and community citizens.

Trade associations are formed within specific industries and concentrate their efforts on issues and topics particular to one trade, profession, or philosophy. Functional trade associations include auto mechanics (Automotive Maintenance Repair Association, amra.org), architects (the Association of Licensed Architects, https://www.alatoday.org/), and marketing professionals (American Association of Advertising Agencies, aaaa.org). Education groups, such as the Association of American Educators, focus on defining competencies and qualifications for teachers and publicly advocating for standards and regulations that affect teachers. Specialized groups also form associations, such as the National Association for the Education of Young Children. Entrepreneurs who are looking for a franchise opportunity might consider an association that caters to franchisees, such as the International Franchise Association (franchise.org) or the American Association of Franchisees and Dealers (aafd.org). Companies interested in "going green" can join the Green Business Network at Green America (greenamerica.org/gbn/). The American Retirement Association (usaretirement.org) or AARP (formerly the American Association of Retired Persons, aarp.org) target retired individuals. Whatever the profession or industry, a trade association is certain to emerge to provide standards, training, support, and services to industry professionals and to be the industry's collective voice to legislatures and government officials in establishing regulations, laws, and licensure qualifications.

Businesses need a steady supply of new customers to replace former customers who no longer have an active relationship with them. The main purpose of *networking groups* is to help entrepreneurs gain new customers. These groups come in all kinds and sizes. Business Network International (BNI, www.bni.com) is dedicated to providing qualified referrals to members. BNI limits its membership to only one person per industry or profession. Members are expected to exchange contact information regarding a qualified potential customer.

Meetup (meetup.com) is a platform where people can meet others with similar wants and interests in an electronic or face-to-face engagement. Meetup’s groups are social or professional, business or entertainment, or relational or transactional. Anyone can start a Meetup group if one doesn’t already exist for their needs or interests. Each group’s founders or members make the rules.

Whether a new entrepreneur needs a lot of support and guidance during the early stages of firm development, or a mature organization needs new potential customers, local organizations can provide an avenue to close connections and professionals who are committed to the local community and its businesses and people. As with all decisions, you must assess each opportunity in terms of the cost of membership and involvement in relation to the benefits you will receive over time.

Business Incubators

Business incubators are normally associations established by a consortium of local organizations such as a chamber of commerce, local banks and other traditional businesses, and universities to provide complementary support to startup businesses and those in the early stages of development. Services provided may include office space for rent at nominal charges; simple business expertise in accounting, legal matters, and marketing; and management support. Some incubators function as independent organizations, each with its own board of directors, whereas others may be stand-alone units of a university program. One of the best byproducts of being associated with business incubators is the communal contact with all the members' connections. **Business accelerators** function much like business incubators. A key difference between incubators and accelerators is equity investment. Business accelerators usually make some type of equity investment in their members' companies. Because the financial commitment raises the stakes for accelerators, these organizations carefully screen their prospects and select only those businesses that have a reasonable chance of financial success. An entrepreneur who joins an accelerator can expect to receive a lot of support in exchange for a commitment to the organization and a share of the profits. Table 12.2 illustrates the differences between business incubators and accelerators.

Business Incubators and Accelerators

Functional Item	Incubators	Accelerators
Duration	One to five years	Three to six months
Cohorts	No	Yes
Business model	Rent; nonprofit	Investment; can also be nonprofit
Selection	Noncompetitive	Competitive, cyclical
Venture stage	Early or late	Early
Education	Ad hoc, human resources, legal	Seminars
Mentorship	Minimal, tactical	Intense, by self and others
Venture locations	On site	On site

Table 12.2

Service Corps of Retired Executives (SCORE)

The Service Corps of Retired Executives (SCORE) is a nonprofit organization based in Herndon, Virginia. SCORE partners with the federal Small Business Administration (SBA) and with retired executives from private businesses to offer education, training, and mentoring to small business owners. According to the SCORE website, it is the largest network of volunteer and expert business mentors, with around 350 chapters. Small business owners can attend a workshop or view training videos available on the website. Templates of financial statements and business and marketing plans are also available on the website. Perhaps the most valuable service SCORE offers is a one-to-one mentoring program that can align a mentor with the specific skills that the business owner needs the most.

LINK TO LEARNING

The SCORE website includes a wealth of online resources on starting a business (https://openstax.org/l/52SCORE) such as online courses and regional workshops. You can also fill out a form to request a mentor (https://openstax.org/l/52SCOREmentor) to help you start your entrepreneurial journey.

Government Agencies

Economic stability over the long term depends on a continual supply of new companies and organizations. A business entity will close when the owner decides to cease operations or achieves the goals of starting the business. Sometimes a business is unable to sustain operations or is forced into closure by regulatory agencies or licensing requirements. Regardless of why businesses close, new businesses must continually arise to replace them and grow the economy. Governments at the federal, state, county, and municipal levels have established agencies and programs to encourage new business development, support new businesses in the early years of operations, and help young businesses mature to the point of self-sustainment. These include the SBA, Small Business Development Centers, Women’s Business Centers, and HUBZones. Figure 12.3 illustrates some of the government agencies that assist small businesses.

Figure 12.3 Several government agencies exist to support entrepreneurs and small business owners. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Small Business Administration

One of the most popular agencies that helps businesses in the startup and early operations stages is the SBA. The SBA was established as an agency of the US federal government in 1953. In 2012, the SBA merged with the divisions of the Department of Commerce, the Office of the US Trade Representative, the Export-Import Bank, the Overseas Private Investment Corporation, and the US Trade and Development Agency. At that time, the leadership of the SBA became a cabinet-level position.

The purpose of the SBA at the macro level is to assist and safeguard small businesses, protect and defend a competitive environment, and fortify the national economy. At the micro level, the SBA helps individuals “start, build, and grow” their businesses and companies through direct counseling, educational seminars and webinars, and public-private partnerships with institutions of higher education and foundations with similar goals and objectives.

Some of the most important activities of the SBA revolve around finances for small businesses. The SBA provides education in finance and money management, and guarantees loans through private lenders for capital, inventory, and startup costs. A business must meet the SBA’s qualifications for funding, but the application and approval of the loan is handled at the local level by officers of a local bank or other SBA-approved financial vendor.

LINK TO LEARNING

Are you looking for a lender to help you start your own business venture? The Small Business Administration's Lender Match page (https://openstax.org/l/52SBALendMatch) helps you find lenders.

Once a business is established and operating, ongoing activities are necessary to generate the cash flow to sustain the business. The SBA supports the ongoing operations of small businesses by being the liaison between small businesses and the federal government on bids and contracts. For fiscal year 2017, the federal government purchased a total of $105 billion[3] in products from small businesses.[4] However, becoming a vendor to the US government is not like selling to a private business or the general public. Free education and training materials are available from the SBA to introduce new businesses to the types of products that the government buys, the government's purchasing process for products and services, and the technical terms the government uses.

The SBA helps small businesses to maneuver through government purchasing processes through education, training, and support. Furthermore, the SBA has programs and funding operations that help economically disadvantaged individuals. These programs are self-contained within the SBA. Public-private partnerships or partnerships with universities or with other nonprofit organizations are also possible.

Small Business Development Centers (SBDCs)

Over one thousand SBDCs are funded through state grants with matching funds from the SBA.[5] Most SBDCs are located on the campuses of local colleges or universities. Others are located in entrepreneurial hubs or are connected with business incubator programs.[6] The coordinator of a local SBDC may be an employee of either the university or the organization that provides the office space. SBDC coordinators provide advice and information to small business owners at no charge because their fees and salaries are covered by the grants. Mostly, the coordinators provide information, steer business owners to other sources of information, and provide a context for making operational or strategic decisions.

Office of Women's Business Ownership

The Women's Business Center (WBC) is a program funded in part or in whole by the SBA to focus specifically on helping women start and operate their own businesses.[7] Women business owners face the same challenges that men encounter, but women normally must add the role of business owner to their list of other personal responsibilities. Also, women have more limitations in access to capital and other financial resources than men typically experience. The WBC can provide support and access to resources that are unique to women. The WBC is operated through independent and educational centers in most states.

3 Small Business Administration. www.sba.gov

4 Robb Wong. "New SBA FY17 Scorecard Shows Federal Agencies Award Record Breaking $105 Billion in Small Business Contracts." *US Small Business Administration*. May 22, 2018. https://www.sba.gov/blogs/new-sba-fy17-scorecard-shows-federal-agencies-award-record-breaking-105-billion-small-business

5 America's SBDC (Small Business Development Centers). n.d. https://americassbdc.org

6 US Small Business Administration. "Find Local Assistance." n.d. https://www.sba.gov/sbdc

7 US Small Business Administration. "Office of Women's Business Ownership." n.d. https://www.sba.gov/offices/headquarters/wbo

Veteran's Business Outreach Center (VBOC)

The SBA operates twenty VBOCs that focus on helping veterans and their families start and operate a new business.[8] A popular program of the VBOC is the Boots to Business program, which assists veterans making the transition from the military to the owner-operator role. Another program dedicated to veterans is the Service-Disabled Veteran-Owned (SDVO) Small Business Concern (SBC) program, administered through the Office of Small and Disadvantaged Business Utilization. To qualify for the SDVO SBC program, the disabled veteran must directly own and control, at minimum, 51 percent of the business and have input into the day-to-day operations as well as a long-term strategy. Requirements vary according to the legal structure that is chosen. Title 13, Section 125 of the electronic Code of Federal Regulations lists other requirements and restrictions to be recognized as an SDVO SBC.[9]

HUBZone

A HUBZone is a geographic location that has historically experienced low employment.[10] Many are also low-income areas because of limited transportation or educational opportunities. Through the HUBZone program, the SBA certifies and supports HUBZone businesses in acquiring government contracts and buying opportunities. Businesses that qualify may receive preferences in pricing. Qualifications for HUBZone designation are explained on the SBA/Government Contracting webpage. As of 2018, the federal government's goal is to award 3 percent of all federal contracting dollars to certified HUBZone business.

12.2 Building the Entrepreneurial Dream Team

Learning Objectives

By the end of this section, you will be able to:

- Understand key resource needs for entrepreneurial ventures: accountant, attorney, banker/financial institution, insurance agent, and industry expert
- Understand the value of developing a cross-functional team

Over the weekend of July 4, 1970, Casey Kasem started *American Top 40*, a radio broadcast that played songs listed in *Billboard* magazine's top 100 singles. What started as a simple compilation of popular songs that were played in ascending order of popularity ended thirty-nine years later on the July 4th weekend of 2009. When Kasem signed off for the final time, he gave credit to those with whom he worked. "Success doesn't happen in a vacuum. You're only as good as the people you work with and the people you work for. I've been lucky. I've worked for and with the very best."[11]

Jay Samit, a vice chairman at Deloitte Consulting LLP, specializes in exponential technologies, a revolutionary method of creating and manipulating information and data for learning, planning, and communicating. Working with multiple clients who each have their own unique limitations and face a wide variety of challenges, Samit and his colleagues at Deloitte devise tailored solutions that resolve each client's problems while overcoming each client's constraints.

Two professionals, two eras, two industries, and two vastly different technologies, but one concept:

8 US Small Business Administration. "Office of Veteran's Business Development." n.d. https://www.sba.gov/offices/headquarters/ovbd
9 Electronic Code of Federal Regulations. n.d. https://www.ecfr.gov/cgi-bin/ECFR?page=browse
10 US Small Business Administration. "Office of the HUBZone Program." n.d. https://www.sba.gov/offices/headquarters/ohp
11 Cord Himmelstein. "Casey Kasem's Final Sign-Off." *Halo Recognition*. June 19, 2014. http://www.halorecognition.com/casey-kasems-final-sign-off

Entrepreneurial success is sustained by those around you. The concept that teamwork leads to individual success is evident in many other areas. All the great National Football League quarterbacks will tell you that they depend as much on their linemen as on their receivers. Pitchers in Major League Baseball need a very close relationship with their catchers, but the fielders are the ones who make most of the outs in the game and can make a pitcher look very good. Surgeons need nurses and anesthesiologists, police officers need good partners as well as dispatchers, ground troops need air support, and airline pilots need fantastic ground crews and maintenance crews, and so on.

In reality, no one works alone. As an entrepreneur, you have the luxury of searching, soliciting, and selecting your own team (Figure 12.4). Entrepreneurial success depends on who is included on that team, and who is excluded from the team. In this section, we discuss advisors and cross-disciplinary teams.

Figure 12.4 Building the right team is crucial. (credit: modification of “Achievement American Analysis” by “rawpixel”/Pixabay, CC0)

Advisor: Accountant

One of the most important decisions that a business owner will make before beginning a new venture is hiring a good accountant (Figure 12.5). Businesses and their owners must be in sound financial health, or the company risks being closed because of financial difficulties. Just as doctors are trained to diagnose and treat health issues and symptoms, accountants are trained to recognize and treat symptoms and issues associated with the financial health of a company. And just as doctors can determine the health of an infant before birth, accountants can determine the likely financial health of a business before it begins.

Figure 12.5 A professional accountant's work is an important asset to any business. (credit: "Numbers And Finance" by "reynermedia"/Flickr, CC BY 2.0)

In the early stages of planning a business, the entrepreneur's personal financial history is the only financial picture that investors, creditors, vendors, or lenders can review. Therefore, it is essential to have a professionally prepared tax return in hand before you approach anyone about opening a new business. Having a professional accountant prepare and file personal tax returns establishes credibility and confidence in an aspiring business owner's financial decision making. Furthermore, when a business owner is willing to let someone else see all of their finances, it indicates to other professionals that the owner is willing to expose a very personal and sensitive realm—money management.

A highly skilled accountant will help any small business owner set up proper procedures that track cash transactions and record financial activities. Accountants assist in creating a **pro forma**, a financial statement that shows how much and where monies will be collected and spent in the early stages of business creation. For an income statement, many of the figures used in a pro forma are hypothetical, a mere guess, but still are loosely based on historical industry or market data. Documenting debt service (explained in the following text) and other fixed expenses can be a simple task. However, projecting future sales with variable costs can clearly become complicated. Many times, approval for a loan or a building lease will depend on reasonable and sound projections of future sales and expenses. Too often, entrepreneurs overestimate income and underestimate expenses. An accountant frequently brings a reality check to the entrepreneur's wishful thinking and keeps income and expense projections credible.

Tax payments, especially payroll taxes, must be made on time to avoid large, costly penalties. Annual income tax for both a business—whether a sole proprietor, a partnership, or a corporation—and the individuals involved can become very complicated. Tax laws constantly change, but a good accountant will know how these changes will affect the company and how the company should respond. Often, the accountant's fees are lower than any penalty and fine assessed by tax authorities.

Besides tracking tax obligations, accountants can help identify trends within the financial picture. Many new business owners focus on profitability of the company and not cash flow. However, cash flow is far more important to the existence of a new company. **Cash flow** includes money collected by the business through revenue and funding versus money disbursed by the business through expenses. In other words, cash flow equals money in minus money out.

It's true that profitability can be affected by depreciation of assets, and an accountant can apply different depreciation rules to reduce profits and tax liabilities. However, the business must maintain positive cash flows to pay its weekly or monthly obligations. Although today's accounting software can easily generate cash flow reports, the expense of paying a professional pales in comparison to the money and time a business owner would spend in purchasing an accounting package, maintaining yearly upgrades, and learning how to run reports.

When a small business needs to expand or make **capital improvements**, major repairs or improvements that add to the life of an asset by improving its longevity, increasing its value or productivity, or extending its usefulness, it may be necessary for the business to take out a loan. Banks expect and require the company to have a professional accounting service prepare and file federal and state tax returns. Without the impartial eye of a professional accountant reviewing the financial health of the company, lenders may consider the business to be high risk and therefore would be unlikely to offer any loans. Expansion may be delayed or halted because lenders want to know if the company has properly managed its existing business before they are willing to finance additional operations and larger financial transactions.

Bankers will want to see not only income statements, balance sheets, and tax returns, normally for the past three years, but also cash flow statements over the same time period. If the company is functioning as a sole proprietor, LLC, or S-corporation (see Business Structure Options: Legal, Tax, and Risk Issues), the bank may require all individuals with management authority or ownership to submit copies of both federal and state individual tax returns plus personal net worth statements. Any investments outside the entrepreneurial company will need to be disclosed as well. All of these requests from lending officers at the bank indicate that they are looking for something. An experienced accountant will be able to interpret their requests, create documents that provide the information they ask for, and advise the entrepreneur on how to address the bankers' concerns.

Inventory management and debt service are other key financial areas where accountants can quickly identify problems that need attention and then offer advice to the entrepreneur. **Inventory management** consists of business operations that include managing the quantity of inventory units in stock, scheduling and cataloguing replacement inventory, organizing shelf location for unit storage, paying for inventory received, and processing, fulfilling, packaging, and shipping customer orders. **Debt service** is repayment of a loan, including principal and interest.

Some vendors will require the same professionally prepared financial documents as bank loan officers do. **Creditworthiness**, or a lender's assessment of how reliable a company is in repaying a debt, is a valuable asset for a business. Being able to buy inventory on credit can greatly improve a company's marketing and overall performance. However, creditors have a different concern about a company's financial health. A vendor that sells inventory on credit may not be able to recoup a loss once the inventory is delivered to the new business. Banks can seize a building, equipment, land, and cash deposits, but creditors are not afforded that luxury. Therefore, creditors are skittish about releasing inventory to financially unstable businesses. Additionally, some businesses may owe inventory or personal property tax on inventory that is in stock.

Advisor: Attorney

If hiring an attorney to keep you out of trouble is expensive, hiring one to get you out of trouble will be exorbitant. Getting an attorney involved with a business in the very early stages, even in the idea development stage, can be a very good investment that will save a lot of legal expenses and protect the company's income. Areas of expertise and the ability to practice in certain areas of the law will vary among attorneys. Entrepreneurs must first determine what legal issue they need help with. Then, they would determine the cost of getting legal help as well as the cost of not getting legal help.

Hiring an attorney can be similar to hiring someone to do construction work on your home. Hiring a general contractor who can do most of the work will be cheaper than hiring a general contractor who subcontracts everything out to specialists. Some attorneys are generalists, with a practice that spans many areas in which the entrepreneur or small business owner will need help. Other attorneys are specialists who limit their practice to a few specific areas of expertise and refer clients with needs outside those areas to other specialists. Generalists are frequently less expensive than specialists, who charge higher fees for their in-depth knowledge of particular areas. In many situations, the entrepreneur or small business owner will not need a high level of legal expertise. When in doubt about hiring an attorney, the new entrepreneur can visit with a few members of their established network to get their input before making a decision.

One of the important questions to ask up front is how the attorney bills for services. Some may charge a flat rate for specific services, whereas others will bill at an hourly rate. Attorneys may add any additional costs and expenses to the client's bill. For example, when filing papers at the county courthouse to register a new company, the attorney may charge for copying, tolls to drive to the courthouse, parking, and mailing fees in addition to completing the actual registration papers. Knowing how the attorney calculates the bill—what fees will be charged and what additional costs will be added—is very important in deciding which attorney to hire.

Attorneys may be associates or partners of a firm. A large firm may have several equity partners and junior associates who are supported by paralegals. Larger firms offer a wider range of expertise and support for your attorney, but that extra help and larger resource pool are available at a higher price. On the other hand, an attorney who is in a stand-alone or small boutique firm may be less expensive but has fewer resources to tap into if necessary and may be unavailable for extended periods of time when actively working for other clients.

An attorney in your specific geographic area or community could be a valuable source of uncommon knowledge. Another consideration to think about when selecting an attorney is the location of their office. Office location may seem trivial, but attorneys in large office buildings probably have higher fees because they have higher office expenses. However, they are more likely to know other business professionals in their building, and those connections may be helpful at some point. Moreover, attorneys are often keenly aware of major developments in markets, such as real estate transactions and development, new roadways, and regulations.

Law practices can be divided into broad categories and specific areas. If you look at the landing pages of many of the country's prominent law schools, you will find only one commonality among all of them—they include specialized areas in their programs. Five broad categories of law that are relevant to the entrepreneur are administrative, civil, corporate, criminal, and family law. For the entrepreneur, corporate and family law are probably the most important, because entrepreneurs may have family investors and personal assets at risk. An attorney who is skilled in family law would know how to protect the entrepreneur as well as family members if the startup business fails. If you are considering starting a business in a regulated profession, such as electrical repair, HVAC, or childcare, you will want an attorney familiar with the state's administrative code. Hopefully, a startup entrepreneur will not need a criminal defense lawyer. One of the first areas where you should consult an attorney is in determining the type of business structure. Any business structure has both legal and tax ramifications. A business attorney should help the entrepreneur select the legal structure that is best for the business, the industry, and the entrepreneur. Each legal structure—sole proprietorship, partnership, or corporation—has its advantages and disadvantages (see Business Structure Options: Legal, Tax, and Risk Issues). The attorney, in collaboration with the accountant, should help advise the entrepreneur about which legal form the business should take and why, not only for tax purposes but also for liability protection for the entrepreneur's personal assets and for ease of operations.

Other issues may arise during the startup stage that would require legal advice. These include branding, patents, trademark registration, and contracts. Will the entrepreneur be leasing a space or purchasing a stand-alone building? If leasing, who is responsible for the safety and well-being of employees and for protection of the equipment and inventory? In the excitement of getting started and making money, entrepreneurs may consider such questions to be unimportant. However, discussing these issues and making decisions before an adverse incident occurs can save the new business a lot of time and money. A good attorney will help keep the focus on important issues before they become catastrophic ones.

Another volatile area for new businesses involves employees and employment law. New business owners may also be new to management. Ignorance of employment laws can be very costly, especially if a disgruntled ex-employee seeks protection from state and federal agencies. Formulating company and employee policies is very important. Having an attorney help develop and use appropriate phrases will be a blessing that you will recognize long after the attorney has cashed your check.

LINK TO LEARNING

Visit the Society of Human Resource Management website with extensive resources for small business owners (https://openstax.org/l/52SHRMresource) on many topics related to employment law, including their Workplace Compliance Newsletter and articles on current news at their site.

Attorneys are professionally trained and educated to argue for their clients and to destroy the arguments of their opponents. Having a good attorney who confronts and debunks the naive beliefs and behaviors of the nascent entrepreneur can help that entrepreneur mature into a professional. As a new entrepreneur, you may not find it easy to leave behind the “employee” mentality and enter the “owner” mindset. The entrepreneurial lifestyle, responsibility, position, status, authority, and so on are foreign to the employee population. Therefore, you may need to undergo a trial by fire. A good attorney, like a good marine drill sergeant, has to destroy the old mindset and develop a new mindset within the new entrepreneur: It’s all mine.

Although a good attorney is necessary to many aspects of a business, the entrepreneur also needs to set limits and not allow the attorney to tread into the owner’s domain. Attorneys should focus on legal issues, not operational, strategic, or—under any circumstances—financial issues. Attorneys may be tempted to go beyond their realm to help out a client, but in reality, they should stay within the areas of law and regulation, and out of operational or strategic decisions. A good attorney will provide information, insight, and recommendations for managing risks, but will not bully a client by insisting on eliminating risks. An entrepreneur should always be ready to terminate the relationship with anyone, including an attorney, who seems to be interfering in areas beyond their domain.

Hourly rates for experienced accountants and attorneys can be frightening. Even if you readily acknowledge that the information and guidance provided by these two professionals is valuable, having the funds to pay for their work in the pre-startup stage of the business can be impractical. Successful entrepreneurs are known for solving problems, and at the very beginning of your own business, you can start solving your own business problems. The question is: How can I get professional advice at discounted rates?

Often, young lawyers and accountants who have just completed their education or received their license to practice will have very few clients. Likewise, those individuals who have been junior partners in larger firms and are branching out to start their own business will have limited clients. Those two scenarios are ripe for seeking discounted billing rates. Both the entrepreneur and the budding professional have a common need but few, if any, paying customers. Therefore, other business professionals or small business owners whose businesses are in the fledgling stage may be willing to offer special rates or payment terms.

Advisor: Banker or Financial Institution

All banks are not the same. Entrepreneurs need to select a bank or financial institution that can meet their current and future needs (Figure 12.6). Local banks that target a small geographic area are an excellent choice for small, locally centered businesses. Officers of the local bank may personally know local business owners, employees of the local businesses, and other key members of the local community. When a small business has a financial need, officers of the company may make decisions based on the reputation of the entrepreneur and the business. Sometimes a local bank will make loans and provide financial assistance with less scrutiny than an entrepreneur would face at a larger bank. For the small entrepreneurial business, banking is personal. Bankers like to see businesses in their backyard succeed.

Figure 12.6 Selecting the right financial institution for your venture will help create a path for security and growth. (credit: “Money Coin Investment Business” by “nattanan23”/Pixabay, CC0)

Large banks with multiple branches in numerous cities, states, or countries may be a better choice for banking services if your company will have broad geographic and financial needs. With employees, customers, and vendors scattered over a large market, a large company is better off having a bank that mirrors that broad reach. For example, if an entrepreneur starts a business in Hutchinson, Kansas, and banks with a local bank in Hutchinson, that intimate relationship between the business and its employees in Hutchinson probably works great. However, as the business grows into the Wichita and Kansas City markets, its banking services should expand too. Likewise, expanding a business across state lines should initiate a thorough review of banking arrangements to ensure that banking services will match the needs of the expanded business.

Large companies with multiple branches or employees over a larger area have bigger demands in banking products and services. They will be better off with larger banks that can respond faster and more effectively to market shifts or individual needs.

Advisor: Insurance Agent

Having insurance is a necessity for every business. Entrepreneurs, however, should not overlook the advantages of an insurance agent’s knowledge and industry insight. Insurance agents ought to be in the entrepreneur’s portfolio of industry professionals. Furthermore, insurance agents likely have other clients who have been successful business owners for many years and may well introduce a new entrepreneur to seasoned veterans.

The insurance industry is a trove of data regarding almost every aspect of any industry or profession. All of that information is at the fingertips of your insurance agent. Agents can obtain information about any industry by running liability reports according to numbers compiled by the **North American Industry Classification System (NAICS)**, a standard used by US federal agencies to collect, analyze, and report statistical information about businesses[12]; the government provides a searchable database related to the codes as well (https://www.census.gov/eos/www/naics/). Every business in the United States is assigned a NAICS number, and insurance premiums are determined by the risk associated within each classification. You can obtain your NAICS number from your federal income tax return form 1120S or 1040 Schedule C. Knowing your business classification and the risks associated with it, your agent can assist you in reclassifying your business and lowering your insurance premiums, a potentially big financial savings.

Advisor: Industry Expert

Studies show industry expertise and skills are vital to successfully launching and operating one's own business. However, a lack of industry skills is not an impenetrable barrier to entrepreneurship. In fact, about 15 percent to 20 percent of successful entrepreneurs have no industry experience or have limited knowledge about an industry before entering entrepreneurship.[13] In the service professions, the entrepreneur's lack of skill is hardly noticeable, but technical industries have a higher success rate for entrepreneurs who already possess the skills needed in the industry.[14] Even if you do have those skills, you are more likely to succeed if you select industry experts who know the ins and outs of your profession (Figure 12.7).[15]

Figure 12.7 An industry expert can advise you and your team. (credit: "woman standing in front of sitting people" by Unknown/Pexels, CC0)

With the industry professional doing the work, the new entrepreneur can focus on the business aspects of the operation while gaining industry experience and insight through hands-on exposure. As many first-time entrepreneurs find out in their first year, they will spend less time on the technical aspects of working in the business and more time managing and working on the business itself. Good collaboration between a technician and an entrepreneur increases the chances of long-term success.

12 Executive Office of the President Office of Management and Budget. *North American Industry Classification System*. 2017. https://www.census.gov/eos/www/naics/2017NAICS/2017_NAICS_Manual.pdf

13 Dawn R. DeTienne and Gaylen N. Chandler. "The Role of Gender in Opportunity Identification." *Entrepreneurship: Theory & Practice* 31, no. 3 (2007): 365–368.

14 Paul D. Reynolds and Richard T. Curtin. "Business Creation in the United States: Panel Study of Entrepreneurial Dynamics II Initial Assessment." *Foundations and Trends® in Entrepreneurship* 4, no. 3 (2008): 155–307. https://www.academia.edu/19325466/Business_Creation_in_the_United_States_Panel_Study_of_Entrepreneurial_Dynamics_II_Initial_Assessment

15 Jeen Wei Ong and Hishamuddin Bin Ismail. "Human Capitals Make Entrepreneur More Entrepreneurial? An Empirical Data from Small and Medium Enterprises in Malaysia." *Journal of Asia Entrepreneurship and Sustainability, 4*(1), 83–105. 2008.

As you begin searching for and interviewing professional advisors such as attorneys, accountants, or industry experts to make your team (Figure 12.8), you should follow a few fundamental principles. First and most important, you—the business owner—are the decision maker. Business owners, not members of the advisory team, reap the benefits of good decisions and bear the cost of poor decisions. Advisors inform, explain options and risks, share knowledge about others with similar situations and their outcomes, and make recommendations. An advisor's role is neither to make decisions nor to "sell" one particular viewpoint. Second, expectations and fees should be discussed before any actual work is done. Often though, a brief visit with a professional may be conducted at no charge so that each party can determine what is needed, whether the professional has the time and skills to meet the client's needs, and whether the client can afford the fees.

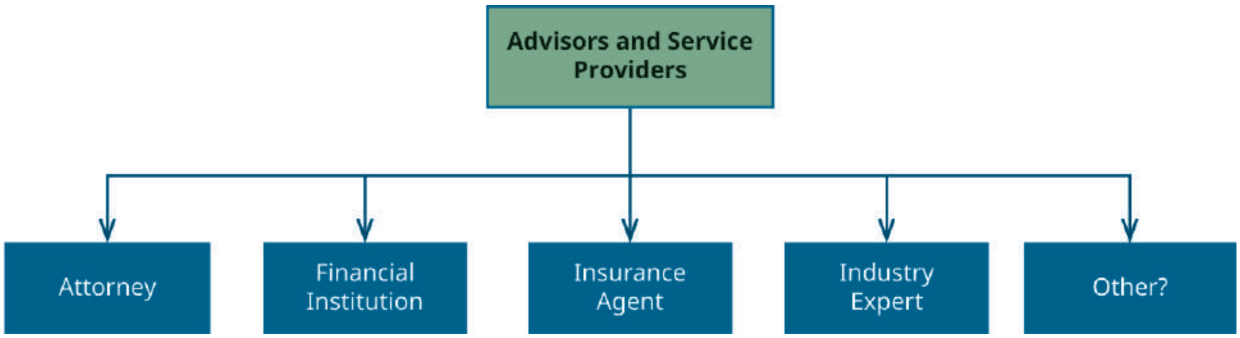

Figure 12.8 Your team should include advisors and professional service providers. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Another consideration is that all professionals have limitations. Licensed professionals such as attorneys and accountants are experts in their respective fields, but they are not necessarily experts in general business operations or strategy. Industry experts may be very knowledgeable in many aspects of the business, but they too have boundaries. Last, shopping for experts to advise you on crucial matters should be based mostly on competence and compatibility, not strictly on fees. Securing the services of a professional is a serious matter and should be treated as such. Yet, it is a business arrangement subject to traditional market factors such as service quality, affordability, accessibility, and change over time.

ARE YOU READY?

Who Am I? Who Am I Not?

Knowing what type of person you are can help you make good career choices. Knowing what type of person your potential employee is can help you make a good hiring decision. Create a list of personality traits that you think you possess. Ask close friends, family members, instructors, or others in your life who will give you their input about your personality. People with all types of personalities and traits can be successful entrepreneurs. The difference is in how you manage yourself and what you do to compensate for areas of weakness.

A reliable tool to identify certain personalities traits is the Sixteen Personality Factor Questionnaire (16PF) developed by Raymond B. Cattell. Visit the Sixteen Personality Factors Questionnaire site (https://openstax.org/l/5216PF) to take the 16PF questionnaire.

1. What factors are reflected that you expected?
2. What factors are revealed that you did not expect?
3. If your results show that you are timid, what might you do to overcome that when you become an entrepreneur?
4. If you tend to be a perfectionist, how might you manage the uncertainties of entrepreneurship?
5. Which traits or skills on your list match or are similar to those listed by your acquaintances? Which responses do not match?

Research the functional skills that you will need to start a business. Create a list of functional skills that you believe you possess. Ask close friends, family members, instructors, or others in your life who will give you their input about your business knowledge and skill. Then:

- Make a list of the functional skills you need for your new business. Add your name next to the functional skills that you have.
- Make a list of people you know who have different functional skills than you. Add their names next to the functional skills you do not have.
- Which of your friends and acquaintances appear on both the personality and functional lists? What do you think this means?

Building a Cross-Disciplinary Team

Rarely does an entrepreneurial venture start or function due to the effort of only one person. “Birds of a feather flock together” may be a popular saying, but it is a very poor organizational strategy for building a team to start a successful business. Diversity is a key feature of successfully managed organizations. Compatibility and collaboration are also important, as each employee is duty-bound to work with, support, and assist other employees when necessary. Having staff with complementary skills and who get along improves the likelihood of success for a new business.

A new restaurant provides a great example of how employees with assorted talents, expertise, and responsibilities are assembled to make a bustling organization profitable. For a new owner, the first hire is a manager. Hiring a good manager with experience means a larger payroll expense but produces better financial dividends over the long term. A good manager oversees all staff as well as all operational functions such as scheduling, buying, pricing, marketing, health code compliance, and business support functions. Perhaps the second key hire is the chef, who is responsible for creating the menu, distinguishing the restaurant from its competitors, and creating repeat customers who want high-quality, tasteful meals.

Front-house employees—the hosts/hostesses, servers, and bussers—play critical roles as the faces and voices of a restaurant. The first experience in a restaurant will leave a lasting impression, so those at the front are obliged to appear and act professional at all times. Servers, who have the most direct contact with customers, are the sales force of the business and the liaison with the chef. Servers’ incomes depend on tips and turning tables, so it is essential for them to have tables cleared quickly and properly prepared for the next group. Servers, therefore, rely heavily on the bussers for those important tasks. In many restaurants, bussers receive a portion of the tips left for the servers, establishing a codependency between those two key positions.

Other positions in a restaurant are the bartender, dishwasher, custodian, payroll clerk, bookkeeper, and so on who must perform their duties accurately and efficiently. Subpar service in any one of these functions jeopardizes the viability of the restaurant. Every employee at each and every level is crucial, individually as well as collectively.

WHAT CAN YOU DO?

Make a List, Check It Twice

Building a team is a skill that you can learn. One of the first steps is to identify what tasks need to be completed and what skills are necessary to complete those tasks. People in all types of leadership positions build teams. Whether they are in government, large businesses, individual retail stores, small businesses, local athletic teams, or schools, leaders go through the same process of identifying tasks and the skills necessary to accomplish those tasks and then searching for people with those skills.

A key to learning is practice. You can practice building a team and then checking with people in charge of various organizations on how well you did. For example, select a local organization that you are somewhat familiar with—a local school, a community athletic league, a church, or a scout group. List the tasks and skills you think are needed to run the organization successfully. Then observe the organization in action. Make adjustments to your list. Ask to consult the manager in charge to see how well you did. How does your list compare with the actual operational structure? How is your list different? What did you overlook? How many people are doing more than one task?

After doing this a few times, you will begin to see organizations from a functional viewpoint. This is a skill any entrepreneur needs to have. What does my business do? What skills are needed to do those activities? Which person will I select to do those activities? If my first choice declines, who will be the backup?

Not only does a business need people to perform functional activities and day-to-day operations, but it also needs people to advise in other areas such as strategy, finances, management, staff, or legal. Should I have sales? Special promotions? Expand my product lines? Raise my prices? Get another investor for expansion? What are your long-term objectives? How will you achieve them? Having individuals you can talk to about your long-term goals is important. Surrounding yourself with those who can ask the right questions, confront you on weak areas, make you consider topics that you had not considered—all without judging you—is important if you have any plans to grow your business.

Create a second list of people you know and trust, a list solely for advising purposes. Members on this list can be from any industry as these are strategic questions, relevant across all industries and markets. They will help with your business strategy and structure, not operations.

A very common organizational structure for a new venture is the **flat organization**, consisting of family members, friends, or professional colleagues who take responsibility for different tasks. The bond that brings this group together in launching this new business is unlikely to bring to the table all of the skills, talents, personalities, perspectives, and viewpoints that can lead to long-term success. Therefore, expanding the team's human resources beyond the founding members who also manage the business is crucial. Although they do not have to become employees, access to them is as vital as having key personnel on your payroll.

An entrepreneur with a creative or big-picture mindset may not want to be bothered by day-to-day activities. If that is the case, then someone else in the business needs to be the analytical, linear-thinking individual who can process information and data to make sound decisions. After carefully considering a situation, collecting information, and studying all relevant facts affecting the business, a *problem solver* can recommend what action the entrepreneur should take, to whom should the tasks be assigned, when to implement the solution, and how much money to dedicate to solving the problem. In other words, the problem solver becomes a lead advisor to the entrepreneur, the manager. If the creative entrepreneur is one side of the coin, the problem solver is the other side. When those two minds work in tandem, good things can happen.

In contrast, an entrepreneur may be a functional expert or licensed professional who is obliged to perform the tasks personally—for example, an HVAC technician, dentist, or professional driver. In that case, a business manager is needed to run the business side of the company. Rules, regulations, and deadlines for business activities are beyond the functional entrepreneur's scope of interest, but they must be complied with accurately and in a timely manner, or the business may close. Like the creative founder who hires a day-to-day manager, a performance entrepreneur needs to hire someone dedicated to business functions.

Successful business owners keep careful track of metrics. They categorize and track expenses and analyze profit margins, production performance improvements or declines, employee attendance, and other measurable activities. Accurately interpreting the financial and operational performance of the company by the numbers provides the management team the information they need to make sound decisions. Having someone on the team with an aptitude for working with numbers is critical. The numbers must speak for themselves. Personnel must remain inside the box when they draw conclusions from data.

However, solutions to problems are not always inside the box. Nonlinear thinking, also known as creativity, or "thinking outside of the box," is sometimes needed to solve problems (see Creativity, Innovation, and Invention). Creativity is the source of many new ideas, products, and processes. With companies facing shorter times of competitive advantage, the entrepreneur needs to be constantly reinventing both self and company.

Over time, as the business grows, the entrepreneur makes the transition from owner-operator of a startup through the small- business phase to being the owner-operator of a mature business. Entrepreneurs eventually need to make the cognitive shift from working in a state of ambiguity to performing methodically in a predictable environment. A business model where routine, repetitiveness, and predictability occur is more appropriate for established businesses because it brings stability and confidence to employees, customers, lenders, and investors alike. Using time-tested business methods and learning from previous experiences, an entrepreneur may avoid pitfalls that could doom a startup company in the early stages.

Every organization—whether a for-profit, not-for-profit, political, religious, or social organization—relies on revenue. For-profit businesses rely on sales as their main source of revenue. Nonprofit organizations, such as community organizations, political groups, or religious groups, depend upon donations, contributions, gifts, and grants. Some nonprofits, such as youth sports leagues, community performing arts groups, or scouting groups, bring in cash through fundraisers or through ticket sales for events. Governments customarily depend on various taxes as sources of revenue. Some local governments receive funds through block grants from their state and federal governments. Having multiple revenue streams improves cash flow and increases the prospects of long-term success.

Recruiting the person who will generate income for the organization should be a high priority during the earliest stages, perhaps even before formal operations, of the business. For a salesperson, grant writer, donor coordinator, or any other title referring to an income-generating position, a startup organization may have to offer a sweeter-than-normal compensation package. If the person can produce revenue and generate cash flow in excess of their total cost of employment, then he or she is worth the costs of higher commissions and bigger bonuses.

Trying to improve short-term financial performance and increase profits by reducing a key employee's compensation is likely to be detrimental over the long term. Losing a good sales rep may make the company vulnerable to losing very important and profitable customers. Failing to retain an effective grant writer could be the beginning of the demise, or at least a major downfall, for a nonprofit. Smart entrepreneurs pay their revenue producers appropriately, even if it means paying them more than the entrepreneurs pay themselves. As the old proverb states, “Never bite the hand that feeds you.”

WORK IT OUT

Design the Business? Build the Product!

Stan enjoys building wooden patio furniture. He started his craft while in high school and worked with a cabinet maker during his college years. For the past twenty-five years, he has been a marketing and sales representative and sales division manager for a restaurant equipment manufacturer. Recently, his company was bought by an international company, and Stan’s entire division was eliminated.

Stan was offered a new position with his current employer, but he would have to move to a new city. His family is against moving. His wife would have to quit her job teaching art in elementary school, his son does not want to miss his senior year of playing baseball, and his daughter has just started a new job at a nearby restaurant.

Stan decided to start his own business making customized outdoor patio furniture. He already owns most of the equipment and tools needed to make the furniture. He has long-term relationships with his suppliers. However, his workshop in the backyard is not large enough to store raw materials or support an assistant. Besides, if he wants to make a living wage, he has to have a large place to handle the volume necessary to be successful yet safe.

Stan is comfortable with the technical aspects of making furniture. He knows how to do marketing and sales, including pricing and financing. What he is not comfortable with is everything else he needs to get the business started. Stan does not want to spend a lot of his retirement funds, so getting started with minimal expense is his goal.

What does Stan need to start his business? What type of professional help does he need and why? Who can help him?

12.3 Designing a Startup Operational Plan

Learning Objectives

By the end of this section, you will be able to:

- Identify the major areas of operations management (money, methods, machines, people, and leadership)
- Develop a checklist of operational needs

From the start, every entrepreneur needs a business plan. Your business plan will keep you focused on the very early stages of the business, when it is easy to be distracted. A written business plan can help redirect you back to your original idea.

Business plans can be divided into four different types: operational, strategic, tactical, and contingency. In this section, the focus will be on the operational plan, the activities that an entrepreneur-owner absolutely needs to do. The core business activities and how those activities interface with customers are key to a business's long-term success. Business plans are discussed in more detail in Business Model and Plan.

Operational Business Plan

In the early 1900s, the mechanical engineer and management consultant Frederick Taylor introduced *scientific management* techniques into manufacturing industries. Since then, operational planning has evolved into a major component of successfully managing a business. An operational business plan details the what, when, who, how long, with what, and how much of company activities. This type of plan may list specific functions: What the activities of the business are, when those activities occur, who is responsible for various tasks, how long each activity will occur, what tools or equipment are required, and how much time and funding are needed.

Operational business plans should be flexible enough to allow for challenges that will occur. Some changes must be made on a daily or even an hourly basis. Other changes may be necessary only occasionally throughout the year. However, the purpose of the operational plan is to provide direction and guidance. This way, everyone in the business knows their specific assignments, who is responsible for individual tasks, and when major events occur.

Creating a table or chart in an Excel or other spreadsheet format can help your planning and scheduling. Figure 12.9 illustrates how work station scheduling for a grocery store can be displayed in an Excel spreadsheet. Functional activities, specific job tasks, work shifts, or work stations are listed as column headings. Hours of operations are listed as row headings. Employees' names are entered into individual cells, showing who is assigned to each specific task or station. The table doesn't show every position, but enough positions are listed to give you an idea of how to use the same format for your own business.

Time	Manager	Front Counter	Produce	Dairy	Register #1	Register #2	Register #3
6:00	Keith	Jamal	Lewis	Justin	Gabriela		
7:00	Keith	Jamal	Lewis	Justin	Gabriela		
8:00	Keith	Jamal	Lewis	Justin	Gabriela		
9:00	Keith	Jamal	Lewis	Justin	Gabriela		
10:00	Keith	Jamal	Lewis	Justin		Shelby	
11:00	Monica	Eleanor	Lewis/Kate	Matt	Gabriela	Shelby	
12:00	Monica	Eleanor	Lewis/Kate	Justin/ Matt	Gabriela	Shelby	
1:00			Lewis/Kate	Justin/ Matt	Gabriela	Shelby	Eleanor
2:00			Lewis/Kate	Justin	Gabriela		Eleanor
3:00				Matt		Shelby	
4:00				Matt	Emily	Shelby	
5:00				Matt	Emily	Parvati	Jesse
6:00				Matt	Emily	Parvati	Jesse
7:00				Matt	Emily	Parvati	Jesse
8:00					Emily	Parvati	Jesse
9:00						Parvati	Kate
10:00					Carol		Kate

Figure 12.9 The table shows a schedule of work stations by hour. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

This type of schedule displays every functional position, the hours that each position has to be covered, and which employee is assigned to that function at what time. The manager can look at this schedule and know that each function has been assigned to an employee during a definite time period. If the work is not being completed, this type of schedule can help a manager make an informed decision about whether to hire more employees. Furthermore, if a problem occurs, the manager knows which employee(s) were working at that station when the problem occurred and can go directly to the employee(s) for information. When an employee is unable to fulfill a shift, the manager can change the schedule quickly to ensure that every task is being completed and every position is attended to.

Individual schedules and assigned work stations can also be displayed in a worksheet (Figure 12.10). This allows the manager to schedule an employee for the proper number of hours per week and helps budget payroll expenses. Employees know where they are expected to be and when they are scheduled to take lunch or dinner breaks, and the manager knows where the employee should be. When operational questions arise, the manager knows who was scheduled to be at the site and can go directly to that employee.

Time	Keith	Eleanor	Jamal	Lewis	Shelby	Jesse	Emily	Carol
6:00	Floor		FC	Produce				
7:00	Floor		FC	Produce				
8:00	Floor		FC	Produce				
9:00	Floor		FC	Produce				
10:00	Floor		FC	Break	R#2			
11:00	Floor	FC	Break	Produce	R#2			
12:00	Floor	FC	Break	Produce	R#2			
1:00	Floor	R #3	FC	Produce	R#2			
2:00	Floor	R #3	FC	Produce	Break			
3:00	Floor	FC	FC		R#2			
4:00	Floor	FC			R#2		R#1	
5:00		FC				R#3	R#1	
6:00		FC				R#3	R#1	
7:00		FC				R#3	R#1	
8:00						R#3	R#1	
9:00								
10:00								R#1

Figure 12.10 This table shows a schedule of employees by hour. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Using tools such as spreadsheets for scheduling and managing day-to-day operations brings organization and stability to daily operations. Managers know that each task has a person assigned to it, and employees know where they should be or what they should be doing throughout the day. Complex businesses with many employees and many functions need more planning and structure. Businesses with very few employees can be less structured. However, a written plan should list most tasks and activities that need to be accomplished, who will do them, and when.

LINK TO LEARNING

Many templates (https://openstax.org/l/52template) and spreadsheets (https://openstax.org/l/52spreadsheet) are available online that small employers can use to organize and schedule (https://openstax.org/l/52schedule) employees. Using key terms—for example, *employee*, *schedule*, *work station*, *template*—in popular search engines can produce multiple results.

ENTREPRENEUR IN ACTION

Scheduling Sounds Simple

Scheduling materials and parts for a fixed operation can be difficult. However, it can be even more challenging to coordinate your personal schedule with on-demand childcare needs near your workplace. Avni Patel Thompson undertook this massive challenge when she started Poppy, an on-demand childcare service, in 2015.

Recruiting customers and employees for any business can be challenging, but when a company business model is centered around customers who have unscheduled demands and employees who want consistent income, the company needs a high-tech solution. Poppy was an app where parents could submit their request for a caregiver. The app's algorithm would then scan all available caregivers who were available during the window of time requested and were located reasonably nearby. After the app did its work, a staff member would make the final decision and confirm the caregiver with the family.

Unfortunately, Poppy succumbed to the overall market and economic conditions plaguing the child care profession and closed in December 2018, but the business model is an example of one way to solve complex scheduling issues.

Questions about Poppy and its scheduling procedures:

- How is an app better suited for this type of scheduling requirements than a full-time employee?
- What requirements are mandated for the customer? Employee? Company?
- Will a new application of technology overcome other economic and marketing factors?
- How reliable is the technology? What potential threats to the "established" method of scheduling are possible when technology is updated?

For tasks requiring attention on a monthly, quarterly, or annual basis, a simple organizer/calendar can be an excellent tool to help organize and remind you of what needs to be done and when. Tasks that you must complete on time throughout the year include payroll tax deposits and reports, insurance renewal applications, permits and license renewals, employee training and recertification requirements, and account billing to certain customers. A calendar also can help you schedule advertising and marketing activities. Some events occur regularly each year at the same time or within a known time frame. This can help remind you when to start your advertising and marketing campaigns.

You can plan for major maintenance and repair in advance or keep track of scheduled price increases, pay raises, adding or removing menu items, rearranging shelving for seasonal products, and major cleaning or maintenance activities.

As you start your business, you may need to make some adjustments to your operational plan. An entrepreneur might overlook factors that occur regularly. Or a new entrepreneur may have considered some factors to be minimally influential when in fact they may be significant. Entrepreneurs might give high priority to influences that never materialize. Once the business is open, customers and competitors may not behave as expected. Employees may have skill sets that were omitted from the written plan, or they may lack needed skill sets. Even a well-written operational plan will most likely need to be tweaked shortly after operations start. But if you formulate your plan correctly at the beginning, your functional operational plan should rarely need a complete overhaul.

Control

One element that should be included in every operational plan is control. In an operational plan, a marketing plan, an employee development plan, or any other type of plan used in business, control refers to the measurement of outcomes and an evaluation of the activities that led to those outcomes. The control element of a business plans answers the questions, “Have we accomplished what we wanted to accomplish?” and “Have we met our goals within the time frame that we wanted?” Without measuring performance outcomes, the entrepreneur does not know if the business is operating as expected, worse than expected, or better than expected.

If a business performs better than expected, the entrepreneur must consider if the original expectations were too low or if some other factor contributed to the better-than-expected performance. On the other hand, if the business performed worse than expected, two reviews must be conducted. First, why are outcomes less than expected and what can be changed to improve performance? Second, how do lower outcomes affect the viability of the business?

Comparing actual outcomes with expected outcomes is a form of internal comparison called **baselining**. Baselining is important because the entrepreneur must conduct a self-evaluation on what the business has done versus what it can or should do. An entrepreneur can decide to adjust a business’s capability after conducting a baseline study. However, internal comparisons should be coupled with an external analysis, called benchmarking. By comparing your business with a close competitor’s or with the industry average, you can get a better idea of how your business fits into the larger market.

Industry Benchmarks

If a basketball team scores sixty-eight points, do they win? If a baseball team scores four runs, do they win? If a soccer team scores five goals, have they lost? The answer to all three questions is simple: We need more information. Without knowing the other team’s score, we don’t know if a team has won or lost. There must be some other score for comparison; otherwise, the points scored are meaningless.

Similarly, businesses need to compare their individual performances with some external performance measurement. The comparison with an industry average, a leader within the industry, or a market segment is called **benchmarking**. Benchmarking allows a direct comparison of your company with the collective whole of the industry or market, or with an industry leader. By looking at several performance measurements, you can see if your company is performing at a level that will sustain itself over the long term or if your company’s local market is atypical compared with another company’s market. If the performance level of a startup company does not match the industry average or the industry leader, that does not mean that the company is poorly managed or cannot be profitable. Underperforming industry leaders indicates only that your company is not the same as those leaders. Frequently, benchmarking against a local market area is better than benchmarking against national leaders or the industry as a whole.

Operations Management

Operations management can be summed up in three words: Get it done! The foundation of operations management is the theory of scientific management. As we have seen, Frederick Taylor developed scientific management to introduce organization, scheduling, coordination, standardization, and cooperation among workers into the production process. Taylor saw a production plant as a large, multifaceted organization with many interrelated activities that should function as one large machine. The activities of each worker within one group had to be coordinated with other workers' activities within that same group. Each worker group had to be coordinated with other worker groups. Worker groups were clustered into larger cohorts. To keep materials moving through the manufacturing process, activities had to be planned, scheduled, and monitored.

Whether you are working in a manufacturing environment in which raw materials are converted into finished products or in a service environment in which customers receive experiences, these five components of operations management—organization, scheduling, coordination, standardization, and cooperation—must be the foundation your firm's activities. To have productive outcomes, the firm must have important inputs: money, methods, machines, people, and leadership (Figure 12.11). If any of these essential management elements are deficient or lacking, the company is probably functioning inefficiently and could be at a higher risk of failure.

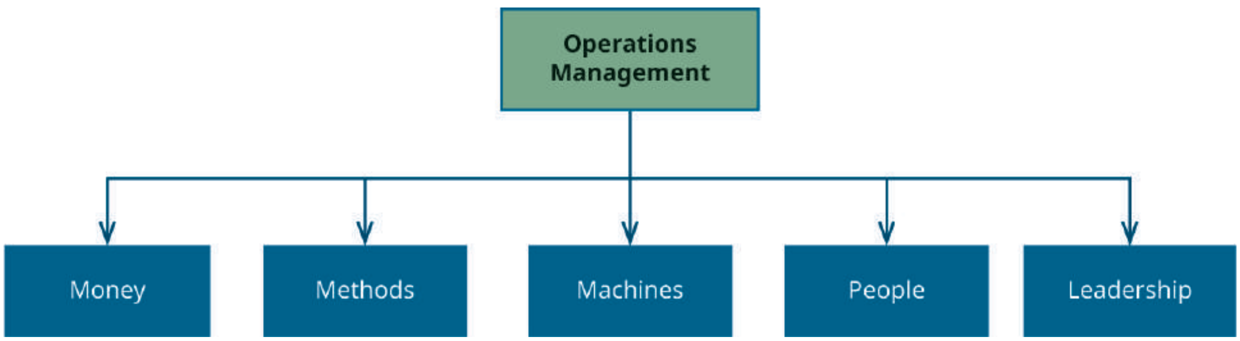

Figure 12.11 Money, methods, machines, people, and leadership form the foundation of operations management. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Money

Three terms—money, cash, and currency—are often used interchangeably, but each has its own distinct meaning and application. Money is any legal instrument that can be used in the exchange of goods and services. Money includes paper money or coins, but it also includes checks or money orders. In developing countries, money might be any physical item that is considered valuable to people wanting to exchange some goods or services. Most money, though, is in the form of cash.

Cash typically refers to physical money or currency, but it also includes deposits in an account (checking, savings, or certificate of deposit) at a financial institution. For example, customers can pay for their purchases with paper money, coins, checks, debit cards, or credit cards. The paper money and coins are taken to the bank for deposit. The debit card and credit card transactions are debited to the business's checking account by its bank. The cash balance of the business increases by the amount of the deposits, regardless of the form of the deposit. The cash balance is shown on the company's balance sheet and is the amount of money the company has available to pay its debts and obligations.

Currency is paper money or coins printed or minted, issued, and backed by a national government. Currency is divided into denominations or units in both paper and coin formats. With the expansion of international trade, along with the expansive movement of people among countries, it is important for an entrepreneur to know how global markets affect the value of money. Each national government decides what denominations of currency to produce. The value of a national currency is determined by the ability to exchange it for another national currency. Raw materials and supplies that originate in another country may increase in price significantly because of a decline in value of the US dollar or an increase in value of the country of origin's money. Likewise, raw materials and supplies may have a price decrease because of shifts in the value of money.

Knowing and understanding how international monetary policies and activities affect a local entrepreneur can be critical to long-term growth and survivability. You must have a clear understanding of projected costs of materials as well as enough funds available at the right time to meet your financial obligations.

Liquidity is a measure of a company's ability to meet its immediate and short-term (i.e., due within one year) debts and obligations. It's a way of describing how well you can cover your current liabilities using your current assets. When a company is liquid, it can meet its financial obligations on time, typically on a very short timeline. If the company pays its bills on time, the risk to lenders is lower, so lenders charge lower interest rates; insurance companies may set lower premiums; and vendors may offer cash discounts for early payments. Maintaining liquidity is vital to the success of a small business, as it may have limited access to other financial options.

Other sources of cash include credit accounts such as a line of credit, a company credit card, accounts payable, loans, or your own reputation and goodwill. A **line of credit (LOC)** is an agreement between a bank and a depositor in which the bank makes available a maximum amount of money the depositor can borrow at any time during the term of the loan. The borrower pays a fee during the term, whether or not there is an outstanding balance, and also pays interest when there is a balance on the loan. All of these sources of cash are more cumbersome and involve more planning and preparation than liquid accounts. However, these nontraditional money sources are typically necessary for a new business owner in order to pay for business activities before the company begins collecting money from its own paying customers. Mismanaging these short-term debt accounts can easily become a burden on a small business. To better manage the financial obligations of the business, the entrepreneur needs to know which financial tools are available, how to use them, and which tool to use for which purpose. Financing is the use of money to conduct company activities. Payment sources for business activities and resources should match the life expectancy of the resource. Long-term debts—such as for land, buildings, equipment, and machinery—should be paid off through long-term financial instruments that are known as secured debt. Ordinarily, a loan used to purchase long-term assets will have a shorter life than the assets. For example, a machine that is expected to be useful for ten years should be financed with a loan that is paid in full in less than 120 months (ten years × twelve months). The purpose of long-term debt is to create revenue that exceeds the loan payment and interest. In this arrangement, the asset pays for itself by generating more cash than is needed to pay the principal of the loan, interest on the balance, costs to operate the equipment, and any additional insurance required or taxes assessed against the equipment.

Short-term or current liabilities, such as payroll, taxes, insurance, and all other operational activities, should be paid for through short-term cash resources. Most short-term payment obligations occur each week (payroll) or at least each month (insurance, rent). Short-term cash resources include sales, accounts receivables, down payments, and line of credit. Confusing long- and short-term financing strategies jeopardizes the financial stability of the company. Mismanagement of finances could create a situation in which the company is unable to pay its bills on time. When a company cannot pay its short-term obligations, it may not be able to operate much longer.

Managing cash collected and spent is one of the two most important responsibilities of the entrepreneur. A positive cash flow exists when cash received exceeds cash spent. A negative cash flow occurs when cash received is less than cash disbursed. All companies and organizations will experience a negative cash flow at some time. However, good managers will have a savings account or access to other cash in order to meet current financial obligations. What is important, though, is to have a positive cash flow over the long term.

Paying bills is not fun, especially when you have little cash to work with. Three popular methods of paying bills include credit, cash on delivery, and deposits on account. An entrepreneur's vendors may use all three payment methods. Likewise, the entrepreneur can use all three to collect monies from customers.

When bills are due and the company does not have enough cash to pay the bills or the timing is inconvenient, the company must use credit. Credit is the promise to pay later for something already acquired. Short-term credit may come with no interest charges or fees, such as accounts payable Entrepreneurial Finance and Accounting. Vendors will routinely allow established customers to take possession of inventory or products without paying for them at the time of delivery. Payment for products is due on a specific day or after a defined period of time.

Often, a vendor will offer terms of payment at the end of the billing cycle. For example, if the terms are net thirty, purchases that a small business makes during one month are expected to be paid for in full at the end of the next month. Payments made after the due date are subject to a penalty and interest. Sometimes a vendor will offer an incentive to pay early, such as a 2 percent discount if the payment is made in less than fifteen days.

Many startup businesses must make payments at the time of delivery, a form of transaction known as cash on delivery (COD). When the delivery is made, the delivery driver or the online agent will release the product to the customer once payment has been received. This payment method can burden a startup that does not have liquidity. On the other hand, a startup business can reduce its losses by requiring COD payments from its new customers, as it receives payments and has the funds to pay its own obligations.

For unique or specialized products, some vendors will require a deposit from the customer before the product is made. This deposit reduces the financial risk to the vendor for a custom product that may be difficult to resell if the original customer backs out of the purchase. It also provides cash to the producer, who needs to buy raw materials to make the finished product. For the startup entrepreneur, paying for products beforehand could strain the cash available for ongoing operations. However, if the entrepreneur's customers provide a down payment before the product is produced, the entrepreneur secures a noninterest loan from the customer.

All three of these payment methods are used in business transactions. Cash generated during each financial cycle must equal to or exceed the expenses paid during each cycle. Otherwise, the company may find itself without any money and be unable to afford to stay in business.

Methods

The study of how work is performed is called **ergonomics**. It involves designing, arranging, and coordinating tools and equipment so that the movement of workers who use them is safe and efficient, and products flow through the appropriate work stations in a timely and efficient manner.

Work methods are perhaps most important when complex machinery and equipment are involved. A progressive movement of products from one stage to the next should reduce the employees' time and effort, which reduces costs. Raw materials should be delivered to the location nearest where it will be used. Moving and storing large inventories at each point of assembly is easier and more efficient than storing parts at another location and moving them to work stations when they are needed. Timely delivery of inventory is equally important. Delivery of materials at the moment they are needed is called the just-in-time strategy. If component failure is detected, the point at which the part was assembled can be identified, and the deficiency quickly corrected.

LINK TO LEARNING

The just-in-time inventory system, developed in Japan during the 1960s and 1970s by the Toyota Motor Corporation, significantly changed production management. To develop a new system, Toyota took advantage of three crucial factors affecting post-war Japan: (1) limited resources, including cash; (2) value-added activities; and (3) reliance on business relationships that are mutually beneficial. They were able to avoid wasted investment and to effectively manage workloads. Watch this video on other common factors between startup entrepreneurs and Toyota (https://openstax.org/l/52FactorToyota) to learn more.

Service industries also apply the assembly line approach.[16] When workers become proficient at their tasks, they can perform the minimum actions needed to complete a task without sacrificing quality.[17] The assembly line approach has given birth to another ergonomic philosophy, lean project management.[18]

Many fast-food restaurants, such as McDonald's and Subway, use the assembly line approach to prepare food quickly and correctly. For example, in making hamburgers, one employee selects the bun, puts the appropriate meat patty on it, and then pushes it to the next worker, who may add onions, cheese, tomato, and lettuce before passing the order to the next station. Once the hamburger is complete, it is passed along to the last worker, who wraps the food and places it in a bag or on a tray.

When employees' tasks are limited to very few functions, repetition of movement makes their work quicker. This specialization results in higher quality. Specialization allows each worker to increase productivity, improve efficiency, and reduce mistakes. This division of labor has become a major component in Western economic models. Adam Smith first explained it in his work *The Wealth of Nations* (1776), using pin makers as his illustration. Smith theorized that reducing the number of tasks required of each pin maker would enable each worker to improve his efficiency of motion, resulting in both uniformity in quality and higher production levels.

This increase in quality and quantity of work increases the productivity and profitability of the worker. Collaboration among workers who work in close proximity occurs naturally. A weakness that materializes with one worker may be canceled out by an increase in another worker's efforts. However, human labor continues to be replaced by machinery and electronic instruments developed during the Industrial Revolution and the modern technology revolution. Nevertheless, human labor is essential on the production line, whether in creating or assembling products or performing services.

Machines

Beginning in the late eighteenth century, the Industrial Revolution shifted work from muscular power to mechanical power. Ever since, humans have used machinery to perform tasks greater than what they could

16 F. Abdi, K. S. Sohrab, and S. J. Seyed Mohammad. "Gleanlean: How to Use Lean Approach in Service Industries." *Journal of Services Research* 6 (2006): 191–206.

17 T. Levitt. *Production-Line Approach to Service.* (Boston: Harvard Business School Publishing, 1972).

18 G. T. Passwater. "Industrialization of the Industry." *BodyShop Business* 18, no. 11 (1999): 92.

achieve by themselves or using large animals. Machines provide consistency of work and higher volumes than human workers at lower costs per unit made. However, the initial outlay of cash for machinery can be large.

For a startup entrepreneur, purchasing machinery can be a difficult, time-consuming, and complicated task. First, one must look at the **total costs of ownership (TCO)**, which is the comprehensive cost of owning large capital items, including initial direct costs, operating direct costs, and indirect costs. Maintaining and repairing operational equipment is difficult, especially when production schedules demand the machine to be operational. Poor planning can be very costly, especially for a startup business, because your ability to produce and deliver products on time reflects on your reliability to both your customers and your employees.

When making equipment purchase decisions, you should consider all the costs associated with the purchase plus the machine’s ability to produce income or lower costs. Such expenses include not only the purchase price but also delivery, installation and setup, calibration, and operational expenses. You should also consider the interest paid on the loan as part of the cost of acquiring the equipment, a factor that many new business owners overlook, but one that a good accountant should be aware of.

Hidden costs to major purchases periodically involve certain operating costs. Too often, new business owners focus on the purchase price, sometimes referred to as the sticker price, rather than on the total costs associated with equipment. Major equipment may require special delivery methods and other shipping costs. Once it is delivered to the site, it may have to be installed by skilled technicians. In some situations, the site flooring may need reinforcing to carry the new weight load, or the electrical supply may need to be upgraded to handle the necessary current. Local, state, or federal inspections may be required to obtain a permit to operate the equipment. Sometimes, liability insurance policies require inspections and permits in addition to government permits. All of these extra expenses add to the overall costs of acquiring the equipment. Many times, these expenses are considered sunk costs, never to be recovered in resale of the equipment or in producing more units.

Purchasing machinery and other major equipment is classified as a capital purchase or capital expense. A **capital expense** is a major purchase of a functional asset that is expected to last longer than three years or that still has financial value after being fully depreciated. Capital items, which include buildings, equipment, machines, and furnishings, are best purchased using borrowed funds so that the business can use its cash to pay for **operational expenses**, which are those associated with daily, ongoing activities of the business, such as inventory, office supplies, wages, insurance, and utilities. When an asset is used as collateral for a debt, the lender places a lien on the asset. The debt then becomes a secured debt, backed by the resale value of the asset. To ease the financial burden of major purchases, depreciation, a reduction in the value of an asset, is calculated as an expense on the income statement, which reduces taxable income and lowers taxable liability.

As a general practice, the payment schedule of a capital expense should be equal to or less than the life expectancy of the equipment. For example, a business may purchase an offset printer that is expected to last twenty years and then finance it through a loan to be paid off before the twenty years are up. Although having the debt paid off before an asset is fully depreciated is ideal, in some instances terms of the loan may extend beyond the depreciation schedule.

Machines have limits to their performance. **Absolute capacity** is the highest volume of units that a machine can produce within a specified time period. **Operational capacity** is the number of units you can reasonably expect to be produced within a specified time period. The difference between the two is **operational reserve**. Because machines may need to be warmed up, materials loaded and unloaded, moving joints lubricated, belts and hoses checked and repaired, or other operational functions performed, machines cannot operate at absolute capacity for an extended length of time.

In calculating production levels, it is easy to overestimate the number of units produced. For an offset printer to work properly, paper has to be loaded, the rollers must be inked, feeder clamps may need adjusting, and one or two test sheets need to be printed to check for ink coverage and crispness of the image. All of these necessary activities take time, but they actually are unproductive. Because each business will have unique requirements and influences upon capacity, the best method is to track your own performance over time and calculate the average. Otherwise, getting input from one of your advisors or a friendly competitor would be sufficient for planning and budgetary purposes.

Machines cost money to operate. Improvement in efficiencies and in production volume is a major motivation in purchasing new equipment. You should consider the increase in units produced, operational costs per unit, decrease in waste, and improvement in quality of products. A grocery store owner who has an old freezer that still keeps food at the required temperature may decide it is worth replacing. Buying a new freezer, with all of the associated costs and improvements in efficiency, has no impact on the number of food items taken out of it and sold. Only the difference in actual cost of electricity between the two units can be considered. However, a die machine that reduces waste and improves the number of molded pieces produced per hour may be worth the investment.

All machines break down, usually at an inconvenient time and place. Trying to repair equipment when it is needed is like a road crew trying to fix potholes without shutting down traffic. Therefore, scheduling **production time**, the amount of time that a machine is actually producing products that are to be sold (also called *up time*), and **down time**, the time when production is not occurring due to repair, restocking inventory, or unscheduled work, are critical areas for management. A schedule of regularly planned maintenance that includes preventive repairs and inspections will reduce unexpected down time and equipment failures. Scheduling repairs before they are necessary keeps equipment running efficiently and smoothly, helps reduce costs over the long term, and allows for better management of expenses. Unexpected equipment failures not only interrupt operations but can delay delivery of products and services to customers. This can diminish your reliability and negatively affect customers’ confidence in your trustworthiness, potentially affecting future sales.

Every machine will become obsolete at some time and will need to be replaced. Having the latest, greatest piece of equipment may be a temptation that your bank account cannot afford. Replacing equipment, whether major industrial equipment that needs professional installation or office equipment that can be set up by employees, is a critical decision. Too often, the criteria for selecting new equipment are the same criteria used to describe the old equipment’s ability. Using old job requirements for new equipment may be acceptable in an industry that undergoes very few changes over a very long time. However, most industries change drastically and need up-to-date equipment.

WORK IT OUT

Generating Interest at Home

Going green is a popular trend today. One way in which power companies are going green is with wind-generated electricity. As of now, almost all wind energy programs are on a large scale, with wind farms consisting of hundreds of towers in rural areas. Stationing wind turbines at individual houses is currently impractical. Zoning restrictions limit the height of structures, costs exceed the benefits for homeowners, and potential sound and sight pollution are a concern for neighbors.

Those concerns apply to the current options for wind turbines. Can you think of other options that would be beneficial, cost effective, and socially acceptable in urban, residential areas? What physical properties would you need to consider? What type of functional capacity is needed? Can a household have more than one type of electrical circuitry for different types of needs? Do we need a product to generate electricity for today’s household purposes? Or should we simply rethink household electrical systems entirely?

Entrepreneurs not only create new products and services, but also redefine the problem. They may need to make adjustments to resolve other environmental factors. For example, there was no need for paved roads before the advent of cars. Businesses that provide gasoline and repair work for automobiles were not necessary before the automobile became popular. The mass-produced automobile changed more than how a product was manufactured—it changed the way people moved.

Consider what happed with Avni Patel Thompson and her childcare business Poppy (Entrepreneur in Action: Scheduling Sounds Simple). What lessons can you learn from her experience as you look at home wind turbines? What similarities are there between a service-oriented company and a product-oriented company? What differences are there between the two? Do homeowners really want a new way to power their homes? What are the similarities of purchasing a major piece of equipment for a home and for a business? What differences are there?

Customer demands within an industry also may change significantly over time, just as a company’s specific needs may shift appreciably. To meet external customers’ new wants and the company’s new internal needs, machinery with new technology and more advanced construction may be mandatory. You should plan three to five years into the future for major purchases of equipment, machinery, tools, facilities, and skill levels. The question is not “What do I need today?” but “What will I need five years from today?”

Trading in outdated equipment may have value that is not always recognized in financial documents. When sales representatives of major manufacturers need to meet quotas, they may be willing to offer a very positive financing plan to place their equipment in your business while removing a competitor’s machine. But you should avoid making the mistake of ignoring your current vendor. Your current machine supplier may be very eager to keep customers and may offer to take your old equipment as a trade-in, which lowers the purchasing price of new equipment. Or your current supplier may be able to offer better terms than competitors or provide supplies as a reward for loyalty. All of these choices eventually lower both purchase and operating costs of new equipment.

To upgrade or keep the old machinery, to buy or lease, to sell or trade in, these are just a few of the questions that business owners contend with in making major purchases. Paying for big ticket items through vendor financing might be easier than borrowing from traditional banks. But when making major equipment purchases, always keep the professional sales representatives close. Their industry insight and knowledge could be more beneficial to you than the equipment itself. People are more flexible, more knowledgeable, and especially more valuable than machines.

People

Searching, recruiting, hiring, and supporting a workforce can be some of the most rewarding and frustrating interactions that a new business owner deals with (see the discussion on human resources in Fundamentals of

Resource Planning for more information on hiring the right people for a business). Selecting the right people at the beginning can be the difference between succeeding or failing in the early years of a business. Many experienced business owners will say that waiting to hire the right person is better than hiring the wrong person now.

For the new entrepreneur, hiring people you know is appealing because it is easy, they are typically very amenable in the startup stages, and they share in the excitement of the new business. **Nepotism** is the hiring of family members and close friends, usually based on their relationship to the entrepreneur rather than on their ability to perform the job. Spousal support and involvement are important in the early stages of a business. Spouses routinely become employees of the new business. Many times, the wife is an unpaid employee if her husband starts the new company.[19] Her commitment may vary from a sporadic involvement to a few hours per month or per week. Women entrepreneurs, however, are less likely to have their husbands participate in the business, especially if the husband is unpaid.[20],[21],[22]

Hiring other family members or friends because of their availability and personal commitment is enticing. Yet hiring family and friends just because they are willing and available can backfire and may produce more long-term harm than good. Sometimes hiring people close to you may discourage qualified candidates from seriously pursuing employment with your new business. Seeing that previous hiring decisions were based upon personal relationships is a discouragement to skilled personnel. Terminating employment of a family member can be truly difficult, especially if that family member is an immediate family member such as parent, spouse, child, or sibling. Difficulties within the family and the business are possible if the situation occurs. Moreover, failing to terminate a family member for cause will predictably destroy morale among nonfamily employees, especially skilled employees.

As a business is getting started, having someone is sometimes better than having no one. At other times, having no one is better than having the wrong one. Eventually, however, the ability to do a job supersedes who the employee is. Furthermore, traditional employees hired from the marketplace eventually will resent seeing more favoritism and leniency granted to family members than to nonfamily members. There is a stark difference between the integration of family and non-family members in a startup environment. The career path is usually short, with favoritism towards family members or longtime friends.[23] A delicate balance between family and nonfamily employees is difficulty to achieve, and new entrepreneurs do not need the additional distractions caused by rifts between family and nonfamily staff members.

Friends from previous employment, college, high school, or the old neighborhood are also popular sources for employees. In the early stages, the entrepreneur has so many issues to tackle and tasks to complete that hiring people they know seems like an easy solution. People build personal relationships through social and personal interactions, outside the needs of the new business. They establish friendships along personal commonalities such as attending the same school or being in the same club or on the same team, not along the subordinate-supervisor spectrum. A sure way to end a good friendship is to hire a friend who is unqualified for the job and place them in a supervisory role. Hiring a friend as a subordinate could lead to a confrontation that could cost the new entrepreneur the support of friends and family.

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19 B. Ndemo and F. W. Maina. "Women Entrepreneurs and Strategic Decision Making." *Management Decisions* 45 (2007): 118–130.

20 J. Kirkwood. "Spousal Roles on Motivations for Entrepreneurship: A Qualitative Study in New Zealand." *Journal of Family Economics* 30 (2009): 372–385.

21 L. Philipps. "Silent Partners: The Role of Unpaid Market Labor in Families." *Feminist Economic* 14, no. 2 (2008): 37–57.

22 B. R. Rowe and G. Hong. "The Role of Wives in Family Businesses: The Paid and Unpaid Work of Women." *Family Business Review* 13 (2000): 1–13.

23 Dan Mcconaughy. "Family CEOs vs. Nonfamily CEOs in the Family-Controlled Firm: An Examination of the Level and Sensitivity of Pay to Performance." *Family Business Review* 13(2): 121–131. April 2004.

Every new owner must be willing to move past the startup phase and into the growth stage, where skills become more important than personal relationships. This natural progression in business maturity requires skilled workers to perform their tasks effectively. Those skills come at a price that may be difficult to match in the early stages of the business, but in the long run, skilled workers will produce more revenue than it costs to employ them. Also, customers expect more from established businesses than they do from an initial startup business.

Entrepreneurs must hire employees who complement them, not only in skills but also in personalities. In all of its various phases—from inception through startup, growth, and expansion—every business faces situations and obstacles that require an assortment of skills and talents to resolve. Some situations demand a strong, direct, or even confrontational approach, which can be comfortable for an extrovert. Other situations may need to be handled more softly and indirectly. An introverted employee who naturally is slow to react may take a passive approach that would be more appropriate in some settings.

A small business can strengthen its staff by hiring people with an assortment of backgrounds and experiences. The collective experiences of the whole staff benefit the business in ways that may not always be easily identifiable. Employees who fit together make a nice place to work and an enjoyable experience for customers.

Sales Force

In Building the Entrepreneurial Dream Team, the sales rep was discussed in the context of the value and importance of generating revenue and cash flow for the business. In this section, the discussion will be focused on the sales force as a component of the personnel working in a for-profit business. However, nonprofit organizations that are also dependent upon sales revenue, as discussed earlier, could apply the concepts as described as well.

Decisions involving a sales force may be some of the most critical decisions made, perhaps even more important than organizational structure and tax status. The sales force triggers the activities that generate revenue, which brings the business to life and sustains it. Without the sales spark, the business becomes a lifeless organization doomed to closure.

A sales force must fit within the overall operational and marketing strategy of the business. The product must be fully developed, its benefits to the customers clearly defined, and the primary target market selected before a sales force is needed. Furthermore, company goals of minimum production levels must be established, and a target revenue high enough to cover expenses needs to be calculated. It is imperative that each of these goals is patently understood and achievable for both the sales force and the company before the sales force is assembled.

The first consideration is identifying the stage of the company. Some entrepreneurs have a true startup business beginning from scratch, whereas others enter entrepreneurship through the purchase of an existing business with established customers and cash flow. The organization, structure, and role of the sales force will depend upon whether the business is in the startup, growth, mature, or decline stage). As the business progresses through each stage, requirements and abilities of the company change as does the external environment of the market.

Deciding whether to self-perform sales or outsource the sales function should be done very carefully and should include research into the tax implications and benefits of using employees versus independent contractors.[24] **Self-performing** involves the employees doing most of the work in a business. **Outsourcing** is the hiring of an outside company or third party to perform a specific task, job, or process, or to manufacture goods. Each option has benefits and limitations. The entrepreneur must consider many factors, ranging from financial strength to market knowledge to sales support capabilities. Hiring sales personnel as employees means the entrepreneur must use time and money to recruit, hire, train, supply with equipment and office materials, and regularly pay the sales force. Outsourcing the sales function to independent contractors may be a viable option, as the entrepreneur would have minimal upfront investment and they would be paid a commission only when they make a sale. Outsourcing is a preferred selection for businesses that are financially straining under cash flow, while self-performing sales is preferred for established, growing companies.[25],[26]

Pay is always a touchy topic. Determining a person’s compensation and income gives the entrepreneur a great deal of power and control over the sales force. It is a very important responsibility that ought to be handled with great care. Issues regarding pay affect not only the employees’ or contractors’ livelihood, but also the company’s financial health and reputation. Furthermore, there are numerous laws and regulations, at both federal and state levels, that place the burden of doing it right upon the employer.

Sales force personnel who are employees must be paid with regular wages. Sometimes, a commission or bonus is paid if sales quotas are met. Regular wages, along with employer-matching payroll taxes and employee benefits, increase fixed expenses to the business. This arrangement may not be sustainable for a startup business. Yet the entrepreneur-employer can benefit from this arrangement by retaining control over employees’ schedules and routines, earning loyalty from staff, and receiving immediate market feedback from the employee.

Outsourced or independent contractor sales reps are paid on commission. This arrangement adds a variable expense to the business, an expense that should only be recognized after a sale is made. In most situations involving outsourced independent contractors, the employer is not responsible for payroll taxes. A word of caution, though, to all beginning entrepreneurs: Determining whether someone is an employee or an independent contractor can become complicated. The burden of doing it right is on the employer. And not doing it correctly can add significant expenses to the business in the form of fines and penalties.

An important factor to contemplate when deciding what type of sales force to have is knowing your position in the market and your market’s characteristics (Figure 12.12). If you are selling to other businesses, business to business, you will have to understand their decision-making processes and buying criteria if you expect to make any sales. On the other hand, selling direct to the consumer, business to customer, has a wholly different marketing strategy. For the nonmarketing entrepreneur, learning about marketing basics ought to be placed on the “to do” list so that conversations with sales force personnel will be productive.

24 C. Stephen Tobin, The Tobin Firm. “Understanding the Differences between Independent Contractors and Employees.” Greater Houston Builders Association (GHBA). June 23, 2016. https://www.ghba.org/understanding-the-differences-between-independent-contractors-and-employees/

25 P. M. Madhani. “Managing Sales Force Compensation: The Strategic Choice between Direct Sales Force and Independent Reps.” *Compensation & Benefits Review* 44, no. 2 (2012): 86–99.

26 P. M. Madhani. “Managing Sales Compensation: A Sales Force Configuration Approach.” *Compensation & Benefits Review* 45, no. 2 (2013): 105–114.

(a) (b)

Figure 12.12 (a) In a business-to-business transaction, a farmer may sell his produce to a grocery store that in turn processes the food for consumer sale. (b) In a business-to-customer transaction, the producer sells his wares directly to consumers. (credit (a): modification of "spectacular salad bar at wholefoods HQ in Austin" by Kevin Krejci/Flickr, CC BY 2.0; credit (b): modification of "Honey" by Phil Whitehouse/Flickr, CC BY 2.0)

An additional market consideration is the sales territory. If you define territories by geographic markers, does each territory have the same potential number of customers? What is the variance in size and the distance from the home office? A similar set of questions arises if the sales force is established along product lines. How are the product lines alike? How are they different? When sketching out the sales force organization and responsibilities, it would be highly advantageous to receive input from potential sales reps or more experienced entrepreneurs who already know how to setup this division of your business.

Agreements made with the sales force must be honored, so make any agreement only after very carefully thinking through scenarios and obtaining insight from trusted advisors. The reputation of the business with employees and customers alike is at stake when employers do not honor agreements with employees, especially those employees who are the face and voice of the business to the market. If a sales rep, employee, or independent contractor decides to separate from your business, they could take their customers' business with them to their next place of employment. Although you could take legal action against a former employee who does this, the bottom line is that you have lost a sales rep and a customer. Avoiding that situation is best for everyone, especially you, the entrepreneur.

Getting the right sales people in place is critical. Having them work in a positive and effective environment is a necessity that cannot be ignored.

Leadership

Terms commonly associated with a leadership position include *owner*, *manager*, *supervisor*, *team lead*, *leader*, and *boss*. Many of these terms are used interchangeably, even though they have some minor differences in meaning, but normally one person will function as both leader and manager in a small business. Some entrepreneurs may be able to switch between these two roles flawlessly and fluidly, so that their followers and even they themselves are unaware that the roles are being filled simultaneously. Nevertheless, some traits and behaviors are associated more closely with leadership than with management.

A key difference between leaders and managers is their role in initiating action. Management is typically concerned with administering and directing an organization's activities. This includes planning, scheduling, coordinating, overseeing, and inspecting tasks performed by staff. The manager ensures that employees who have been hired to perform duties perform those duties as expected and at a level of quality and quantity acceptable.

A leader, on the other hand, instills within others a desire to perform. This is more of an internal motivation, a psychological approach, which the leader develops via words and actions. Like the results of the manager's approach, the results of motivation will be evident in the employees' performance. The difference lies within the minds and souls of employees.

Employees will work for their manager because they are obligated to on the basis of assigned roles and positions of authority. Employees will work for a leader because they want to achieve the same goals and accomplish tasks to satisfy themselves as well as their leader.

You can find many lists that describe either characteristics or qualities of a good leader. Only a few have been included here. Descriptions of good leadership can be divided into the following categories: personality, competencies, locus of control, and style.

Personality describes the characteristics of a person as shown by their actions and words. Effective leaders typically are easy to get along with, have a positive attitude, engage others, and display self-confidence in their skills. When entrepreneurs begin looking for employees, working very closely together necessitates that they get along and enjoy each other's company.

Working for someone who does not know what they are doing can be very difficult, if not impossible. Therefore, good leaders know what their competencies are and are very good at what they do. Employees as well as competitors and regulators recognize high job-performance skills. Sometimes, a very skilled leader becomes an industry expert with a reputation throughout the industry and gives training at conventions, conferences, and trade shows. Good leaders are also keenly aware of the skills they lack and readily admit their incompetence in those areas. Hiring a skilled employee who compensates for your shortcomings is a high priority.

Locus of control is the belief that you have or do not have control over events that occur in your life. If you have an internal locus of control, you believe you have significant control and influence over events that occur in your life. An external locus of control—the opposing view—means you believe you have very little control, if any, over events that occur in your daily life. Effective leaders have an internal locus of control and feel certain that they influence and control events, situations, and people in their lives and, specifically, in their business. When crises arise, effective leaders take charge and begin making decisions to get control of events. Employees, customers, and others connected to your business will rally around you if they are confident that you can take control of the situation and directly deal with the challenges.

The three common leadership styles are autocratic, democratic, and laissez-faire. Each of these approaches to leadership is effective but can also be ineffective. The approach that works is best determined by the industry, structure, environment, and requirements of the job.

Autocratic leaders make decisions by themselves and view employees as subordinates who must follow instructions without hesitating or questioning. Autocratic leaders are necessary in situations where decisions are needed quickly, the leader is highly trained and skilled in the work requirements, and the outcomes can be very serious. Democratic leaders engage their staff and seek input before making decisions. This approach works well if the organization or industry is complex, many different departments or employees are affected by the decisions, and a broad range of information is needed to make good decisions. Laissez-faire leadership allows staff to work independently, mostly without supervision or direct input from the leader. This approach works best when the employees are highly educated and skilled, tasks among employees are not closely interrelated, and staff are self-motivated.

Leadership has been studied for many centuries, and the debate continues. You can find examples of good and bad leadership in many organizations including the military, sports, government, and business. Leadership traits are like hands in a poker game—they are all good and bad. The difference is the situation. For an entrepreneur, knowing the industry, the market, the competitive environment, the customer base, and the employee pool are starters for determining which leadership traits and style would be effective. If you decide you are not matched to the environment or situation, then you could engage someone who does possess the traits and skills that better match your current needs.

Operational Needs

When starting your business, the first question you need to ask is whether anyone wants to buy your product or service. Creating a new product or service is easy. In fact, 70 percent to over 95 percent of new products introduced every year are classified as failures.[27] With more than 30,000 new products introduced every year, you could reasonable guess that between 21,000 and 27,000 are failures.[28] On the contrary, only 5 percent to 30 percent of new products are successful. So the question is valid: Will anyone buy my product or service?

With such a low success rate, you will need to conduct careful research and small trial runs to determine the viability of your new products. You need to know not only whether anyone will buy your products but whether customers will pay your price, so that the business can make a profit, or at least break even. You need to ask these two very important questions up front, because if the answer to either one is “No,” you have no need to do anything else.

A second series of questions that you need to address focus on the location of the company’s operations. Where will you locate your business? Will you rent or buy a building or facility? Does your facility need to have easy access in a high-traffic area? Or can it be in a quieter area, where costs are lower? In addition to access and costs, will your business be located within a competitor’s influence? It would be unfortunate if you negated all the positive factors of your great product and viable business plan by selecting the wrong location.

Besides deciding on a proper location, you also need to consider the size of your facility. Selecting a structure that is too small from the very beginning may handicap any growth in the early stages of your business. Having to move to a larger facility soon after beginning operations could be detrimental to your operations. On the other hand, selecting a facility that is too large puts pressure on cash flow, as you will pay rent or a mortgage for an unproductive building space. Finding the balance between “big enough to grow into” and “small enough to afford with low sales” is a predicament faced by many business owners, whether new entrepreneurs or seasoned veterans.

You will need to make similar decisions about furniture, equipment, and furnishings. These items are available for purchase or lease. Sometimes a lease is better, as the initial payments may be lower but over time, buying equipment and furniture can help improve cash flow once the items are paid for. However, deciding on how much, what quality, and what size can be difficult. Good equipment sales representatives can be a big help in making equipment decisions.

To get started, you will need to determine the proper inventory levels. How long is the shelf-life of your inventory? Some products have a long shelf-life, whereas others may perish quickly. Ask yourself “How much

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27 M. Emmer. “95 Percent of New Products Fail. Here Are 6 Steps to Make Sure Yours Don’t.” *Inc.* July 6, 2018. https://www.inc.com/marc-emmer/95-percent-of-new-products-fail-here-are-6-steps-to-make-sure-yours-dont.html

28 J. Schneider and J. Hall. “Why Most Product Launches Fail.” *Harvard Business Review*. April 1, 2011. https://hbr.org/2011/04/why-most-product-launches-fail

do I need?” and “When will I need it?”

Before beginning a business, you may need licenses and permits. Buildings must be inspected and approved prior to occupation for business activities. Building permits may require electrical, plumbing, HVAC, and structural inspections of building systems and physical features. Accounts for water, gas, and trash pickup must be made prior to occupying a facility. Table 12.3 summarizes the operational needs you should consider when launching a venture.

Checklist of Operational Needs	
☐ Item 1	Determine the legal organization of your business for tax purposes (sole proprietorship, partnership, or corporation). Select the legal structure of your business for operations and management control [limited liability company (LLC), general partnership or limited partnership, C-corporation, or S-corporation].
☐ Item 2	Decide on a name for your company. The company name becomes its official legal name for federal and state purposes. A corporate name can be anything that is currently not in use by another company. A trade name may be different from the official name. The trade name should reflect the product or industry.
☐ Item 3	You and any other principals of your business write and approve articles of incorporation, bylaws, or management agreements.
☐ Item 4	File organizational papers with the secretary of state (SOS) or its corresponding office in the state in which the company is founded. The SOS returns the registration or charter documents to the company.
☐ Item 5	You and other principals make cash payments to the company for starting the bank account.
☐ Item 6	Obtain a federal employers identification number (FEIN) from the Internal Revenue Service. This is the company’s federal tax number for income and payroll taxes and filings.
☐ Item 7	Obtain a state employer’s identification number from your state’s employment commission. This is the company’s state tax number for filing unemployment and sales tax reports and payments.
☐ Item 8	Be sure your trade name or assumed name certificate is filed and approved by the appropriate county and state offices if it is different from the corporate name.

Table 12.3

Checklist of Operational Needs	
☐ Item 9	Secure your business phone number, website, email, and domain name. Order your business cards.
☐ Item 10	Open a bank checking account with the appropriate corporate and trade name, authorized signers on the signature card, and all other documents that your bank requires to open a business account. Order debit cards or credit cards as necessary. Deposit your startup funds. Set up and test your business deposit processes.
☐ Item 11	Both you and your officers and partners sign agreements regarding the business.
☐ Item 12	Buy or lease your office space. Your local or city government will grant you a certificate of occupancy to occupy the building. You may need additional inspections before final approval: building, fire, health, and plumbing.
☐ Item 13	Open utilities, water, electric, gas, garbage, and phone accounts.
☐ Item 14	Post required notices in a prominent place according to regulations. Common locations are near the timeclock, break rooms, front cash register, or other public location.
☐ Item 15	Apply for and post as required your license for business, either by federal, state, county, or municipal government.
☐ Item 16	Apply for and post as required your license and permits for employees or specific types of products or services.
☐ Item 17	Obtain insurance for your building, liability for business, and worker’s insurance. Some states allow businesses to exempt themselves from workers’ compensation with proper notice to employees.
☐ Item 18	Order and install furniture, office equipment, shelving, and so on.
☐ Item 19	Order your inventory and make your product list with pricing, price sheets, or menu boards.
☐ Item 20	Recruit and hire your employees. Training and certification may be required for specific functions such as bartenders, cooks, drivers, forklift operators, or first aid personnel. Be sure employees’ training in specific job functions is completed before opening. The first day of operations is typically a low-key event to ensure that everything is working as planned and that your staff know their roles and responsibilities. This gives you time to correct any weaknesses or shortcomings before the general public is aware that your business is open.

Table 12.3

Set the grand opening several days to a few weeks after the actual opening of business. Invited guests may include investors, city officials, family members, special customers, former employers, business neighbors, and competitors.

LINK TO LEARNING

Forbes magazine has various resources such as this step-by-step guide for entrepreneurs (https://openstax.org/l/52StepEntrepr2) and this list of eight steps for entrepreneurs (https://openstax.org/l/52StepEntrepr3) on starting a new business. The federal SBA list of steps (https://openstax.org/l/52SBAsteps) is also available. Review each list. Which one best matches your entrepreneurial situation?

Key Terms

absolute capacity highest volume of units that a machine can produce within a specified time period

baselining internal comparison of actual outcomes with expected outcomes

benchmarking comparing one's own company's performance with an industry average, a leader within the industry, or a market segment

business accelerator organization formed by an alliance of business professionals who assist entrepreneurs in their startup or early stage businesses in exchange for an equity investment in the entrepreneur's company

business incubator organization formed by a consortium of established professionals or organizations assisting startup or early stage businesses that provides office space, financial support, technical support, or advisors whose specialized skills in management and marketing complement the technical talents of the entrepreneur

capital expense major purchase of a functional asset that is expected to last longer than three years or that still has financial value after being fully depreciated

capital improvements major repairs or improvements that add to the life of an asset by improving its longevity, increasing its value or productivity, or extending its usefulness

cash flow money collected by the business through revenue and funding versus money disbursed by the business through expenses

closed group formal, structured group of individuals who have a strict process or specific criteria that applicants must meet before being accepted as members

creditworthiness lender's assessment of how reliable a company is in repaying a debt

debt service repayment of a loan, including principal and interest

down time time when production is not occurring due to repair, restocking inventory, or unscheduled work

ergonomics study of how work is performed

flat organization organizational structure where owners, executives, or key decision makers interact directly with staff at all levels, with very few if any mid-level managers

hybrid group group of individuals who have a loose and flexible set of criteria for membership and function within a very broad set of guidelines; certain criteria may be required of regular members, but guests are frequently accepted with no long-term commitment expected

inventory management business operations that include managing the quantity of inventory units in stock, scheduling and cataloguing replacement inventory, organizing shelf location for unit storage, paying for inventory received, and processing, fulfilling, packaging, and shipping customer orders

line of credit (LOC) agreement between a bank and a depositor in which the bank makes available a maximum amount of money the depositor can borrow at any time during the term of the loan; the borrower pays a fee during the term, whether or not there is an outstanding balance, and also pays interest when there is a balance on the loan

liquidity measure of a company's ability to cover its immediate and short-term (i.e., due within one year) debts and obligations

nepotism hiring family and close friends because of personal relationships rather than for their skill sets

networking process of establishing and maintaining bilateral relationship with other people to exchange information, ideas, products or services, and money

North American Industry Classification System (NAICS) standard used by US federal agencies to collect, analyze, and report statistical information about businesses

open group informal, loosely organized group of individuals who have no formal process for joining or leaving the group, and who focus on a specific activity or social cause

operational capacity number of units that can reasonably be expected to be produced within a specified time period

operational expenses expenses associated with daily, ongoing activities of the business, such as inventory, office supplies, wages, insurance, and utilities

operational reserve difference in unit capacity between absolute capacity and operational capacity

outsourcing hiring an outside company or third party to perform a specific task, job, or process, or to manufacture goods

pro forma financial statement that shows how much and where monies will be collected and spent in the early stages of business creation

production time amount of time that a machine is actually producing products that are to be sold; also called *up time*

self-performing when employees do most of the work in a business

total cost of ownership comprehensive cost of owning large capital items, including initial direct costs, operating direct costs, and indirect costs

trade association group of companies or employees of companies in a specific industry, business structure, or social cause

Summary

12.1 Building and Connecting to Networks

Entrepreneurial networking is interacting with other people who have a common interest that eventually leads to the exchange of goods and services for payment. You must be comfortable approaching, talking to, and working with other individuals in order to build the circle of associates, colleagues, and professionals that you will need to start and operate your business. Likewise, you must be willing to offer your expert knowledge and professional skills to others. A good networker supports others in the community through sharing information and passing along personal introductions to expand everyone’s networks.

People do business with those they know and trust. Connecting with people in face-to-face meetings through group membership is valuable but so is the power of social media avenues dedicated to professional connections, exchange of information, and support, such as LinkedIn. Networking is not easy or free. Some of the costs other than money include time, fear, and dedication. Because entrepreneurs are willing to invest the money, spend the time, take the risks, and stay with it, economic success for communities and individuals is possible.

12.2 Building the Entrepreneurial Dream Team

The idea that entrepreneurs are isolated loners and solo performers in the market, doing everything themselves, having absolute self-reliance, is a myth. Successful entrepreneurs quickly seek outside advice, rely on professionals in supporting areas, and are very good at establishing and maintaining personal relationships with key individuals. Perhaps their essential skill is their ability to identify, connect, and trust those individuals who can help them succeed in their personal entrepreneurial journey.

Whatever the entrepreneur can do best is what he or she should focus on doing. Other required tasks can be assigned to employees, service providers, or consultants. However, it is very important that the functions having a direct effect on customers and sales are performed proficiently, because that is what generates revenue for the company. Entrepreneurs must assess their own skillset and willingness to execute tasks, then identify employees and outside professionals to fill in any gaps.

12.3 Designing a Startup Operational Plan

Success is best defined as achieving what you want. Without some kind of plan, you can never be successful. Whether they are entrepreneurial owners or management employees, business managers need to have a written plan so that everyone can be certain of what tasks are needed, who is assigned those tasks, and when those tasks are scheduled. Recording and tracking financials is imperative in any business. Knowing where money is coming from, to whom it was sent, how much, and why are crucial to being a responsible business professional.

Without a business plan that encompasses all major aspects of your business, you may find yourself without a business. If that happens, you may very well ask, “How did I end up here?” Unfortunately, the answer is likely to be, “I don’t know.” On the other hand, a successful business professional can look back and say, “I did this, and this is how I did it.”

Review Questions

1. What is “networking”?

2. What types of networks are created in a business relationship?

3. What types of organizations on college campuses can provide opportunities for building social networks?

4. What are some opportunities for you to develop the skills you need to establish personal relationships with people that you do not know?

5. What is most likely the largest social group connected with a university? Why is being a member of this group valuable?

6. How do government agencies at all levels support entrepreneurship?

7. Who selects the entrepreneur’s team? Why is this important?

8. Why is selecting an accountant a critical decision?

9. For the startup entrepreneur, what finances are considered relevant?

10. What are some differences between large banks and small banks as they relate to an entrepreneurial startup business?

11. What resources do insurance agents have to gain industry specific information, especially about liability, operations, and challenges?

12. What relationships are possible for sales reps and small, startup businesses? What are the benefits to each?

13. Why is a functional or operational business plan necessary?

14. Many operational business plans provide some very specific steps to take and sometimes are very detailed. What are some situations in which rigid schedules can be a hindrance or a deterrent to effective operations?

15. What simple tools can an entrepreneur use to get organized and do what is necessary throughout the month or year?

16. What is benchmarking? Why is it important? What are some limitations of benchmarking?

17. What is cash flow?

18. What is credit? What are some “instruments” of debt?

19. What are some differences between “absolute capacity” and “operational capacity”? Why do they need to be distinguished?

20. Explain nepotism. Why might it beneficial to an entrepreneur? Why may nepotism be detrimental to an entrepreneur?

Discussion Questions

1. How are social connections made in early life the same as those made on the college campus? How are they different?

2. What are some benefits of professional associations that are not available from government agencies or departments?

3. How is the role of government agencies with regard to entrepreneurship different from the roles of industry and trade associations?

4. How does the SBA help aspiring entrepreneurs?

5. Why is it important for government programs to offer grants to organizations, both public and private, to educate and assist entrepreneurs at no charge?

6. What are some risks associated with surrounding yourself with others who are similar to you in background? Industry experience? Education? Age? Personality? Ability to process information?

7. If the figures on a pro forma are hypothetical, then why go through the exercise of creating a document with fake numbers?

8. What are some disadvantages of having licensed professionals such as accountants and attorneys offering advice to an entrepreneur?

9. A young, very creative, artistic woman wants to start her own graphic design business. If she is out of the office looking for new clients, she is not producing any work that generates income. What are her options?

10. What can happen if a new business does not have any kind of business plan? What if the business plan that was originally written is not effective after the business starts?

11. Why are schedules important? If the new business owner keeps a schedule only in their head and does not write it down, what might be some weaknesses of that idea?

12. Why is benchmarking relevant? What are some conditions in which benchmarking against national figures would be less accurate? How would you find information regarding benchmarking?

13. Why is cash flow more important than profit? If a company does not have enough cash, what are possible ways for it to get more cash?

14. Why is money management so important to a business? What are the consequences if money is mismanaged?

15. When is the assembly-line approach appropriate in service-oriented businesses? What are the benefits of using the assembly-line approach in this type of work?

16. How does the term “division of labor” apply to the concepts of “jack of all trades” and “specialist”?

17. What is the difference between capital expenses and operational expenses? What type of financing should be used for capital expenses? Operational expenses? Why?

18. Why should hiring the right people take precedence over buying the right equipment?

19. How do the needs of a small business and its founder change from the startup stage to the growth stage?

Case Questions

1. Smart phones are everywhere today. You probably have one nearby right now. However, access to landline phone service has not been complete for very long, and wireless service is not as widespread as many people might think. The first phone lines (landlines) connected Boston and Somerville, Massachusetts in 1877. The last town in the United States to receive landline service was Mink, Louisiana, a small community 100 miles south of Shreveport, which received landline service in early 2005. Check any major US wireless carrier, and its maps have gaps in service. Building networks of any kind takes planning, money, and time.

A. What are some similarities between an entrepreneur starting a new business in a new profession in a new market and a telephone service network?
B. How are the requirements for a telephone network infrastructure like those for a new entrepreneur?
C. What are some estimated costs, not necessarily monetary ones?
D. What are some benefits to an entrepreneur who enters a market with established networks?
E. How do established networks save the entrepreneur valuable money and time?
F. With limited resources, what criteria should an entrepreneur use to determine priorities of spending time, effort, and money in developing networks?
G. Does each criterion have equal weight? Why or why not?

2. The Internet Association (IA, https://internetassociation.org/) was founded in 2012 as a trade association devoted to Internet-based companies. Founding companies included Google, Amazon, eBay, and Facebook. These Internet-based companies founded this new trade group because they did not have a voice in Washington, DC, with respect to potential regulations and laws. The IA has synergy—more influence as a group than each company would have individually.

A. What prompted the formation of the IA?
B. Was it for marketing purposes?
C. Management support?
D. Industry advancement?
E. Regulatory influence?
F. What are some secondary purposes for the IA?
G. How might the original purpose of the organization shift as the industry matures?
H. Will small companies enjoy the same benefits of the larger founding organization?
I. Any new venture involves substantial risks and costs. How might a new Internet startup benefit from joining the IA?
J. How else do the large corporations benefit besides having a say in the political discussion in Washington, DC?
K. What time commitment should a new business make before expecting any positive return on investing time and money in a trade association?
L. If joining the IA requires a membership fee, what determinants should you use to place a value on the amount spent for dues?
M. What benefits of a trade association may be not easily linked to membership expenses?

3. In 1989, the new NFL owner of the Dallas Cowboys, Jerry Jones, fired the legendary coach Tom Landry and hired one of his former college football teammates, Jimmy Johnson, as the new head coach. Johnson faced the same problems that a new entrepreneur has: Who should be on my leadership team? What should be their responsibility? Out of twelve key coaching positions, Johnson kept only three coaches from Landry’s staff in the same positions and moved one coach to a different position. Within four years (1993), the Dallas Cowboys, under head coach Jimmy Johnson, won Super Bowl XXVII with six of the original coaches Johnson hired his first year still in the same positions.

A. How is a startup similar to an existing organization that needs to be turned around? How are they different?
B. What are some reasons to surround yourself with others instead of taking the attitude that “I can do it myself?”
C. For any leader, what are some reasons that skills in identifying and recruiting key people are more important than technical skills?

4. Every four years, the United States elects a president. Although the incumbent might be reelected, the United States is guaranteed to have a new president at least every eight years. On winning the election, the new president must identify candidates for cabinet positions. Some potential candidates decline the invitation and voluntarily withdraw themselves from consideration. Those who accept the invitation are put through an intensive screening process. The president then submits cabinet-level nominees to the US Senate for confirmation. As in any close group, recruiting and selecting individuals to join the presidential cabinet is critical for the president to achieve any objectives or goals.

A. What kind of experience is beneficial to members of a board of directors for a local performing arts group? Should they be experienced in industry? Government? Fundraising? Management? Marketing? The arts?
B. Besides experience, what other type of backgrounds should be considered? What about board members' ages? Education? Gender? Residency? Financial Status? Connections to local or regional major employers?
C. What can a new entrepreneur learn from an executive director of a nonprofit about selecting candidates to build a winning team? How important is it that some candidates decline to join the board? How long should members be on the board?
D. How important is diversity in building a winning team? What skills must the entrepreneur perfect? What skills can be learned and developed later by the entrepreneur? Why is a variety of backgrounds, in the technical field and outside of the industry, important?
E. Who is the actual team leader? (1) Entrepreneur? (2) Strongest personality? (3) Smartest? (4) Most technically skilled? (5) Financier? (6) Most experienced in management?

5. Narciso Gómez has worked in the service department at an auto dealership for about twenty-five years and has served as the service manager for the past seven years. He is qualified for retirement through the dealership but wants to open his own business. He is looking at buying a franchise, either a Jiffy Lube quick oil-change franchise that is for sale or a new SuperGlass Windshield Repair franchise. Both are automotive service and repair related, where he has plenty of experience.

A. Besides his technical skills, what does Narciso need to consider before purchasing a franchise business?
B. How might the estimated volume of work required to generate enough sales to cover his financial obligations affect his decision?
C. The Jiffy Lube business model requires a four-bay facility. What does Narciso need to calculate in developing his business plan?
D. The SuperGlass Windshield Repair is an on-site repair model whereby the technicians drive to the vehicle's location for work. What should Narciso's main concerns be in developing a business plan for this business model?

6. Han Jia-ying was an office manager for a construction company until she decided to be a stay-at-home mother with her kids. Her former employer has called her to take over some administrative work at home, such as payroll processing, payroll tax filings, bookkeeping, and other general administrative work. Her employer has said that some of his customers probably could employ her for their general administrative tasks.

A. If she works from home, what type of scheduling issues does Jia-ying face? What might be some interruptions to her ability to meet specific deadlines, such as processing paychecks each week?
B. If Jia-ying needs additional help, what options does she have? Would she be wise to hire an employee or seek some support from someone else? Who might that be? What problems might Jia-ying encounter when seeking a nonregular employee?
C. Jia-ying will need new office equipment, including a new computer, a new scanner/printer, phone service, Internet connections, and so on. However, she is not tech savvy. How might she best manage working from home by herself, especially is something goes wrong or does not work?

Suggested Resources

12.1 Building and Connecting to Networks

Association of Chamber of Commerce Executives: acce.org

BNI: Business Network International: https://www.bni.com

HUBZone: https://www.sba.gov/offices/headquarters/ohp

Service Corps of Retired Executives (SCORE): https://www.score.org

Small Business Administration: https://www.sba.gov

Small Business Development Centers: https://www.sba.gov/sbdc

Women’s Business Centers: https://www.sba.gov/offices/headquarters/wbo

Veteran’s Business Outreach Centers (VBOC): https://www.sba.gov/offices/headquarters/ovbd

12.2 Building the Entrepreneurial Dream Team

Traits: Personality and Instinct

Cattell’s 16PF: https://openpsychometrics.org/tests/16PF.php

Kolbe Conation Index: http://www.kolbe.com

Typical Traits & Characteristics of Entrepreneurs:

https://smallbusiness.chron.com/typical-traits-characteristics-entrepreneurs-18325.html

Good Characteristics of an Entrepreneur:

https://smallbusiness.chron.com/good-characteristics-entrepreneur-18385.html

Attorney: State Bar Associations for attorneys in specific states:

New York: http://www.nysba.org

California: http://www.calbar.ca.gov

Texas: https://www.texasbar.com

Florida: https://www.floridabar.org

Accountant: National Association of State Boards of Accountancy (All fifty states Accountancy Boards are here with active links): https://www.nasba.org

Team Building Activities:

Three Teambuilding Exercises: http://www.entrepreneur.com/article/224212

Seven Team Building Ideas: http://www.entrepreneur.com/article/330594

Success Factors for Entrepreneurs:

Fifteen Entrepreneurial Key Success Factors:

http://www.entrepreneurshipinabox.com/852/entrepreneurial-success-factors/

Ten Qualities of Successful Entrepreneur:

https://www.under30ceo.com/10-qualities-of-a-successful-entrepreneur/

12.3 Designing a Startup Operational Plan

American Customer Satisfaction Index: https://www.theacsi.org/

North American Industry Classification System: https://www.census.gov/eos/www/naics/

US Census Bureau: https://www.census.gov/

US government contracts: https://www.sba.gov/federal-contracting/contracting-guide/basic-requirements

US Department of Commerce Homepage: https://www.commerce.gov/

US Department of Commerce, Bureau of Economic Analysis: https://www.bea.gov/

US Department of Labor Homepage: https://www.dol.gov/

US Department of Labor, Bureau of Labor Statistics: https://www.bls.gov/bls/blswage.htm

Yahoo Finance: https://finance.yahoo.com/

Scheduling programs and templates:

https://getsling.com/blog/category/scheduling/

https://wheniwork.com/features

https://schedulebuilder.org/

Employer hiring costs of employee: https://gusto.com/tools/employer-tax-calculator

Payroll program: https://onpay.com/payroll-calculator-tax-rates

13 Business Structure Options: Legal, Tax, and Risk Issues

Figure 13.1 Focusing time and energy on planning a business can help an entrepreneur avoid or minimize legal issues. (credit: modification of “hammer books law court lawyer” by “succo”/Pixabay, CC0)

Chapter Outline

Introduction

Entrepreneurial businesses are the heart of the US economy. Small businesses—those with fewer than 500 workers—employ almost one-half of the US workforce (47 percent according to the US Census Bureau’s Annual Survey of Entrepreneurs)[1] and are responsible for offering thousands of new products and services each year. The information in this chapter can help entrepreneurs successfully start and operate a business. Startups function best when the owners have a strong understanding of the legal aspects of entrepreneurship. Important legal issues such as business structure (entity selection), incorporation process, taxation, capital acquisition, and employment policies require that entrepreneurs obtain good advice and make sound decisions before they commence operations. They must make additional decisions that relate to the role of the business in the community, which is a key component of corporate social responsibility. The combination of good advice and sound decisions will help entrepreneurs successfully navigate a complex matrix of considerations.

1 US Census Bureau. *Annual Survey of Entrepreneurs (ASE)*. 2016. https://www.census.gov/programs-surveys/ase.html

13.1 Business Structures: Overview of Legal and Tax Considerations

Learning Objectives

By the end of this section, you will be able to:

- Understand why a business's purpose is an important role in the initial business structure decision
- Identify major types of business structures (corporation, LLC, partnership, sole proprietorship, joint venture)
- Distinguish between for-profit and not-for-profit purposes and structures

The structure of a new business creates the legal, tax, and operational environment in which the business will function. In order to choose a business structure, entrepreneurs need to have a clear understanding of the type of business they seek to establish, the purpose of the business, the location of the business, and how the business plans on operating.

For example, a business that plans to qualify as a nonprofit—Section 501(c) of the Internal Revenue Code—will be treated differently from a business that aims to earn a profit and distribute the profits to its owners. Therefore, the first step in any entrepreneurial endeavor is to establish the nature and purpose of the business (Figure 13.2).

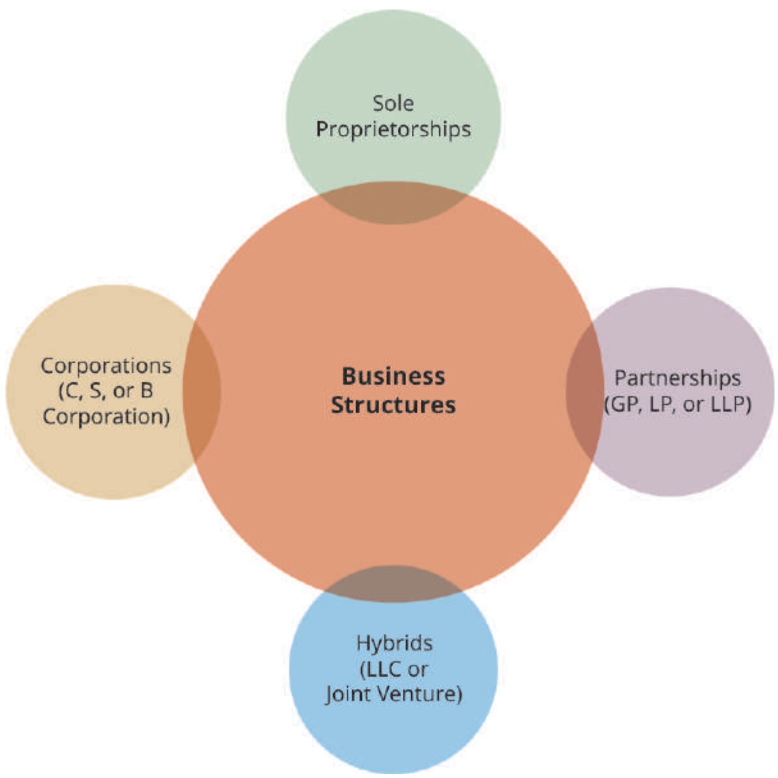

Figure 13.2 There are several basic business structures: sole proprietorships, partnerships, corporations, and hybrid forms. Partnerships may be structured as a general partnership (GP), a limited partnership (LP), or a limited liability partnership (LLP). Hybrids are usually formed as a limited liability company (LLC) or a joint venture (JV). The designations of "C" and "S" corporations refer to which chapter of the Internal Revenue Code they appear in; B corporations are structured to meet standards of serving certain social purposes. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

One of the most important initial decisions an entrepreneur must make, from a legal perspective, is the legal organization of a business, called the **business structure** or *entity selection*. The choices are varied, with several basic entities, each with several variations, resulting in multiple permutations.

Many business ventures, regardless of humble beginnings, may have the potential to evolve into significantly larger business ventures. This is what makes the initial decisions so important. The founders should think through every step of business development, beyond the inception or formation, and consider the possible paths of the business. How an entrepreneur organizes the business, or which business structure they choose, will have a significant impact on both the entrepreneur and the business.

Business structure options include traditional choices such as corporations, partnerships, and sole proprietorships, and hybrid entities such as limited liability companies (LLCs), limited liability partnerships (LLPs), and joint ventures (JVs). Each structure carries different requirements to set up, different requirements to fulfill (such as taxes and government filings), and varying ownership risks and protections. Entrepreneurs should consider these factors as well as the expected business growth in selecting a structure, while being aware that the structure can and should change as the business venture grows.

For example, if you think you want to share authority, responsibilities, and obligations with other people, your best choice would likely be a partnership, in which other people contribute money and help manage the business. Alternatively, if you prefer to manage the business yourself, a better choice for you might be a single-member LLC, assuming you can borrow money from a lender if needed. Conversely, if you think your idea is so popular that you may grow rapidly and want the ability to raise capital by selling interests in your business through equity or debt, then a corporation would be your best choice. You should obtain legal and tax advice about your structure.

ARE YOU READY?

Becoming an Informed Entrepreneur

If you are an entrepreneur with an idea for a startup, ask yourself if you are ready to make important decisions. How much do you know about taxation, incorporation, or liability? If you don’t know at least some of the basics, you may have to depend on a lot of advice from accountants and attorneys, and that is very expensive. If you spend too much money on advice, you have too little left for something else such as advertising and marketing.

Establishing a Business Purpose

A clear understanding of the business purpose helps direct the entrepreneur toward the most appropriate business structure. The **business purpose** is the reason the entrepreneur forms the company and determines who benefits from it, whether it is the entrepreneur, customers, or some other entity. (The business purpose is different from a business mission or vision.) Drafting the expectations of the entrepreneur and how the business will operate, with a careful analysis of how the business will generate cash flows, realize profits, and to whom the business will owe its primary obligations, is the start of determining the appropriate business structure. A written business plan (see Business Model and Plan) will help the entrepreneur develop the best legal structure in which the business is to operate because the legal structure of the business should be tied to the nature of the business.

Once the entrepreneur is clear on the nature and purpose of the business, consideration of the business structure follows. The first consideration is whether the entity is being created to produce a profit for its owners or shareholders, or whether it will be structured as a not-for-profit entity. A second factor is the state of incorporation, as state law defines each business's creation, with different states permitting different types of entities and various legal protections. Additional considerations include how the structure facilitates bringing in new investors, allows the owners to transfer profits out of the business, and supports a potential subsequent sale of the entity. Taxation is also a crucial aspect of business success, and the business structure or entity directly affects how it is taxed.

ARE YOU READY?

Drafting a Business Purpose

Can you write an outline of a business purpose? Try this: Your university's tutoring center is crowded, and those students who need extra help are struggling to find it. You have decided to start a new company to match those students with student tutors at your university. Who determines how much a tutor can charge? Is it a set price, a surge pricing model like Uber, or is it up to the tutor? How much of a profit do you make? In essence, you must determine the purpose of your business. Read this IRS article about shared-economy businesses (https://openstax.org/l/52IRSsharedbus) to learn more.

For-Profit versus Not-for-Profit Businesses

Owners form businesses for one of two purposes: to make a profit or to further a social cause without taking a profit. In either case, there are multiple options in terms of how a business is structured. Each structure carries its own tax consequences determined by the owners' financial requirements and how the owners want to distribute profits. The structure, in turn, determines the appropriate income tax return form to file.

Characteristics of For-Profit Businesses

A **for-profit business** is designed to create profits that are distributed to the owners. There are multiple entity structures used in for-profit business entities including corporations, LLCs, partnerships, and sole proprietorships. Many for-profit business owners seek some form of limited liability, and thus form a corporation or an LLC, each of which carries with it specific legal attributes. Additionally, for-profit business entities are subject to a variety of local, state, and federal taxes and filings. Liability and tax issues will be discussed later in this chapter.

For-profit businesses are commercial entities that generally earn revenue through the sales of products or services, whereas nonprofits are organized for social purposes. Nonprofits are allowed to provide assets or income to individuals only as fair compensation for their services. For-profit businesses can be either privately owned (such as an LLC) or publicly owned and traded (such as a corporation). Publicly held and traded corporations sell stock or interests, and must abide by special rules to protect shareholders, whereas privately owned businesses may be less regulated. Regulations may vary by state and by type of incorporation.

Characteristics of Not-for-Profit Organizations

A **not-for-profit organization (NFPO)** is usually dedicated to serve the public interest, further a particular social cause, or advocate for a common shared interest. They must follow particular regulations regarding eligibility, government lobbying, and tax-deductible contributions. In financial terms, a not-for-profit organization uses its surplus revenues to achieve its ultimate objective, rather than distributing its income to the organization's shareholders, partners, or members. Common examples of not-for-profits include educational organizations such as schools, colleges, and universities; public charities such as the United Way; religious organizations such as places of worship; foundations; trade organizations; and issue-advocacy groups. Other organizations also considered NFPOs include nongovernmental organizations, civil society organizations, foundations that provide funding for various activities, and private voluntary organizations.[2]

Nonprofits are usually tax-exempt as categorized by the US Internal Revenue Service (IRS), meaning they do not pay income tax on the money they receive for their organization. These types of organizations are created under state law (but also subject to federal and local laws) and are typically created for the common good.

To operate as a not-for-profit business, most states require that the entrepreneur create a corporation that has the specific purpose of acting in the public interest. This type of corporation does not have owners but has directors charged with running the organization for the public good, subject to bylaws. Some states only require a minimum of one director, whereas other states may require three or more directors. This is an important consideration for an entrepreneur because the nonprofit corporation will need the approval of all of the directors, and not just one person for its creation. Careful vetting of the directors is the best policy of any entrepreneur since directors have a duty to the corporation.

Because state laws vary, a not-for-profit corporation created for the common good in one state needs permission from another state to operate in that state. The permission is typically an approval from the other state's secretary of state memorialized in the form of official documents or permits. When operating in different states, the entrepreneur needs to make sure that the business follows all laws, rules, and regulations for each state.

Another issue to consider is the creation of a not-for-profit business organization for a particular purpose. One example of a special-purpose organization is an alumni organization, usually incorporated as a 501(c)(3) nonprofit, which incorporates to raise money for a college or university for a specific reason, such as student scholarships. Alternatively, a booster club may incorporate to receive donations for a single function, such as the women's soccer team. These organizations may need additional approvals prior to the creation or start of operations, depending upon state and local legal requirements. Each state typically has different requirements; depending on the federal tax regulation under which the entrepreneur is attempting to qualify, there may be additional federal regulations. This is why the entrepreneur needs to fully understand the purpose of the business they are starting and the legal operating environment before selecting the business structure. While NFPOs play an important role, most entrepreneurs form for-profit businesses; therefore, the remainder of this chapter will focus primarily on for-profit business entities.

2 International Center for Not-for-Profit Law (ICNL). "What Is the Difference between 'Non-Profit' and 'Not-for-Profit'?" 2013. http://www.icnl.org/contact/faq/index.html#difference

ENTREPRENEUR IN ACTION

Determining the Purpose of Your Business—Profit versus Non-Profit, or a Little of Both?

The Approach Used by Gravity Payments' Entrepreneur Dan Price

Figure 13.3 Gravity Payments has led the way in exploring how employee and C-level salaries function for the company in terms of profits, living wages, and ethical considerations related to those issues. (credit: modification of photo provided by Gravity Payments)

Sometimes, a business may be a for-profit company yet act in a way that some may think exhibits a not-for-profit philosophy. Most startups must address their business purpose. In other words, is the primary purpose of the business to enrich the owners or is it to spread the benefits of success to the workers? The history of Gravity Payments (Figure 13.3) illustrates this issue.

In 2011, an employee earning $35,000 a year told his boss at Gravity Payments, a credit-card payment business, that his earnings were not sufficient for a decent life in expensive Seattle. The boss, Dan Price, who cofounded the company in 2004, was somewhat surprised, as he had always taken pride in treating employees well. Nevertheless, he decided his employee was right. For the next three years, Gravity gave every employee a 20 percent annual raise. Still, profit continued to outgrow wages, so Price announced that over the next three years, Gravity would phase in a minimum salary of $70,000 for all employees. He reduced his own salary from $1 million to $70,000 to demonstrate the point and help fund the company-wide salary increase. The following week, 5,000 people applied for jobs at Gravity, including a Yahoo executive who took a pay cut to transfer to a company she considered fun and meaningful to work for.

Price recognized that low starting salaries were antithetical to his values and to what he felt was a large part of his business purpose. A majority of the initial cost of his approach to employee salaries was absorbed by making less profit, yet revenue continues to grow at Gravity, along with the customer base and the workforce. Price believes that managers should measure purpose, impact, and service as much as profit.

- Do you think an entrepreneur can successfully operate a for-profit business while paying its workers substantially more than the competition?

13.2 Corporations

Learning Objectives

By the end of this section, you will be able to:

- Distinguish between C Corporations, S Corporations, and B Corporations
- Distinguish between privately and publicly held corporations
- Explain how corporations are taxed

A **corporation** is a complex business structure created by filing the appropriate documents with the state of incorporation (Figure 13.4). They are created when the original incorporators (owners) file a formal document called the articles of incorporation, or other similar documentation, with a state agency, often the secretary of state's office or the state division of corporations. Corporations operate as a separate legal entity apart from the owners. The owners are called shareholders and can be individuals, other domestic or foreign corporations, LLCs, partnerships, and other legal entities. Corporations may be for-profit or not-for-profit, as discussed previously.

STATE OF [STATE]
CERTIFICATE OF INCORPORATION
A STOCK CORPORATION

The undersigned Incorporator, desiring to form a corporation under pursuant to the General Corporation Law of the State of [State], hereby certifies as follows:

1. The name of the Corporation is ______________________________.
2. The Registered Office of the corporation in the State of [State] is located at ______________ (street), in the City of ________ , County of _____________ Zip Code _______. The name of the Registered Agent at such address upon whom process against this corporation may be served is ______________________________.
3. The purpose of the corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of [State].
4. The total amount of stock this corporation is authorized to issue is ______________ shares (number of authorized shares) with a par value of $ ___________ per share.
5. The name and mailing address of the incorporator are as follows:
   Name ______________________________
   Mailing Address ______________________________
   ______________________________ Zip Code ________

By: ______________________________
Incorporator

Name: ______________________________
Print or Type

Figure 13.4 This is a sample short form of the document that is filed with the Secretary of State’s Office to form a corporation. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Incorporating a company means that the corporation operates as an entity that has some of the same rights as an individual. For example, individuals and corporations can sue and be sued, and corporations have the rights to own property, to enter into and enforce contracts, to make charitable and political donations, to borrow and lend money, and to operate a business as if the corporation were an individual. Most states require a corporation to be registered in that state in order to conduct business operations and to enter into and defend lawsuits in that state, especially if the business was incorporated in a different state. Registration is not the same as forming the initial corporation; it is simply the process of filing informational documents by entities that have already been incorporated in another state. States also tax the operations or sales a corporation makes in the state in which it has certain operations.

Overview of Corporations

Corporations are the only type of entity that the law allows to sell shares of stock. No other entity, like an LLC or a partnership, may do so. Those individuals or other entities that buy stock become shareholders and own the corporation. Some corporations have millions of shareholders, and others have as few as one. State incorporation laws vary: Some require at least three shareholders, but others allow a one-owner business to incorporate. Thus, an entrepreneur may start a company as the sole owner of the company and later incorporate and sell shares of stock or bonds to other investors in the company.

Corporations sell, or issue, stock to raise **capital**, or money, to operate their businesses. The holder of a share of stock (a shareholder) purchases a piece of the corporation and has a claim to a part of its assets and earnings. In other words, a shareholder is now an owner of the corporation. Thus, a share of stock (also called equity) is a type of security that signifies proportionate ownership in the issuing corporation. Stocks are bought and sold predominantly on stock exchanges, although there can also be a private sale between a seller and a buyer. These transactions have to conform to a very complex set of laws and government regulations (e.g., the Federal Securities Acts of 1933/34), which are meant to protect investors.

Use of a corporation allows the entrepreneur to shield themselves, and other owners, from personal liability for most legal and financial obligations. The benefit of limited liability is one of the primary reasons entrepreneurs incorporate. However, the administration of a corporation requires more formality than other types of entities, such as sole proprietorships and partnerships. A corporation must follow the rules for such entities. The requirements include maintaining bylaws, holding annual shareholder and director meetings, keeping minutes of shareholder and director major decisions, ensuring that officers and directors sign documents in the name of the corporation, and importantly, maintain separate bank accounts from their owners and keep detailed financial and corporate records. A failure to follow the rules could lead to the loss of limited liability, known as “piercing the corporate veil.”

WORK IT OUT

Piercing the Corporate Veil of Limited Liability

As we have discussed, entrepreneurs should generally form a separate legal entity to limit personal liability arising from business obligations, such as contracts. Incorporating or organizing as an LLC can limit owners’ personal liability to the extent of their investments. This liability shield is not without exception, however: in particular, a situation called “piercing the corporate veil.” A recent 2018 case example (Woodruff Construction, LLC v. Clark, No. 17-1422 [Iowa Ct. App. Aug. 15, 2018]) demonstrates this point.

Factual Overview: The defendant was the sole owner of a corporation and entered into a contract to remove sludge for the plaintiff at a waste treatment facility. The defendant never completed the work. The plaintiff sued and won a $400,000 judgment against the corporation for breach of contract. However, the plaintiff was not able to collect from the corporation due to insufficient assets. The plaintiff then asked the court to pierce the veil of the corporation, which would allow recovery from the corporate owner’s personal finances.

Piercing the Veil: Evidence showed that although the defendant kept a separate bank account for the corporation, he had commingled its funds with his personal finances, which is a distinct violation of fiduciary duty. He used the bank accounts for the corporation interchangeably with other bank accounts. Furthermore, the defendant did not follow required corporate formalities because he had no bylaws or resolutions, no voting records, and no documentation of or minutes from shareholder meetings.

Finding: The court allowed the plaintiff to pierce the corporate veil. This means that the defendant, the sole owner of the corporation, had to pay over $400,000 out of his personal funds. (Note: Although it is true that LLCs have fewer formal requirements, this case would likely have had the same result if the owner were an LLC because the rules are essentially the same for piercing the veil of limited liability.)

Critical Thinking:

- How can you protect yourself from this happening to you?

Most corporations use a three-part (or tripartite) approach to ownership and management (Figure 13.5). After the corporation is created and operations start, the shareholders typically elect a board of directors, and the board has oversight responsibilities for the operations of the company. The board then appoints officers who are responsible for the day-to-day operations of the corporation.

Figure 13.5 In a tripartite approach, three groups are involved in owning and managing a corporation. Shareholders elect directors who appoint officers. Shareholders are owners, and directors/officers may be, and typically are, shareholders. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

For small organizations, state law allows shareholders to directly manage a company without using a board of directors. This type of corporation is a closed corporation or a closely held corporation, and is common for entrepreneurial startups. State incorporation law, coupled with federal tax law under the IRS, regulates the formation and operation of a closely held corporation. The basic rules state that, generally, a closely held corporation is a corporation that has more than 50 percent of the value of its outstanding stock owned (directly or indirectly) by five or fewer individuals at any time during the last half of the tax year.[3]

3 US Internal Revenue Service. *Publication 542 Corporations*. n.d. https://www.irs.gov/faqs/small-business-self-employed-other-business/entities/entities-5

C Corporations, S Corporations, and B Corporations

The categorization of corporations as either C corporations or S corporations is largely a tax distinction. An **S corporation** is a "pass-through" entity, where shareholders report and claim the business's profits as their own and pay personal income taxes on it. Alternatively, the government taxes a **C corporation** at the corporate level, and then levies taxes again on the owners' personal income tax returns if corporate income is distributed to the shareholders as dividends.

Conversely, the distinction between B corporations and C or S corporations is not one based on taxes at all, but rather on purpose and approach. A certified **B corporation** is a business that meets a very high standard of social and environmental performance, public transparency, and accountability to balance profit with social purpose. B corporations can also be C corporations or S corporations. Figure 13.6 summarizes these types of corporations.

The Unique Nature of B Corporations and/or Benefit Corporations

A new form of nontraditional, for-profit corporation is the benefit corporation, which may or may not also be a B corporation. While *B corporations* and *benefit corporations* share some common goals, B corporations go through a certification process. Becoming a certified B corporation is a formal process that involves compliance with various standards and an audit of this compliance (managed by the B corporation organization).[4] The essence of these new B corporations is that "they recognize the imperative to do no harm and create positive impact throughout the value chain."[5] According to the B corporation organization, these certified businesses are legally required to consider the impact of their decisions on their workers, customers, suppliers, community, and the environment. As of 2019, there are approximately 3,000 certified B corporations in sixty-five countries, covering 150 different industries.[6] The B corporation certification is somewhat like a seal of approval for businesses voluntarily trying to be socially responsible. A benefit corporation is a corporation recognized by a governmental agency under state law (about thirty states now recognize benefit corporations with legal requirements of higher purpose, accountability, and transparency) but does not carry the certification of a B corporation. However, in terms of purpose as related to corporate social responsibility, the two entities are very similar.

The benefit corporation's objective is directed toward maximization of benefits for all stakeholders, meaning that the company benefits any person with an interest or concern in the business. It does not only maximize stockholder profits. Maximization of stakeholder benefits is directed through the corporate charter of a benefit corporation. The state of incorporation directs how benefit corporations are created, but generally, this "new governance model broadens the perspective of traditional corporate law by incorporating concepts of purpose, accountability, and transparency with respect to all corporate stakeholders, not just stockholders."[7] This means that the use of this type of business structure needs to be carefully considered by the entrepreneur because the responsibility of the business will include consideration of the stakeholders outlined in the corporate charter, not just the profit maximization for the shareholders.

4 Certified B Corporations. n.d. https://bcorporation.net/

5 Network for Business Innovation and Sustainability. "B Corporations, Benefit Corporations, and Social Purpose Corporations: Launching a New Era of Impact-Driven Companies." October 2012. http://nbis.org/wp-content/uploads/2012/10/ImpactDrivenCompanies_NBIS_Whitepaper_Oct2012.pdf

6 Certified B Corporations. n.d. https://bcorporation.net/

7 Morris, Nichols, Arsht, and Tunnel. *The Public Benefit Corporation Guidebook*. n.d. http://news.mnat.com/rv/ff00272e4c8b3699806e25d24c48a286df5bf926

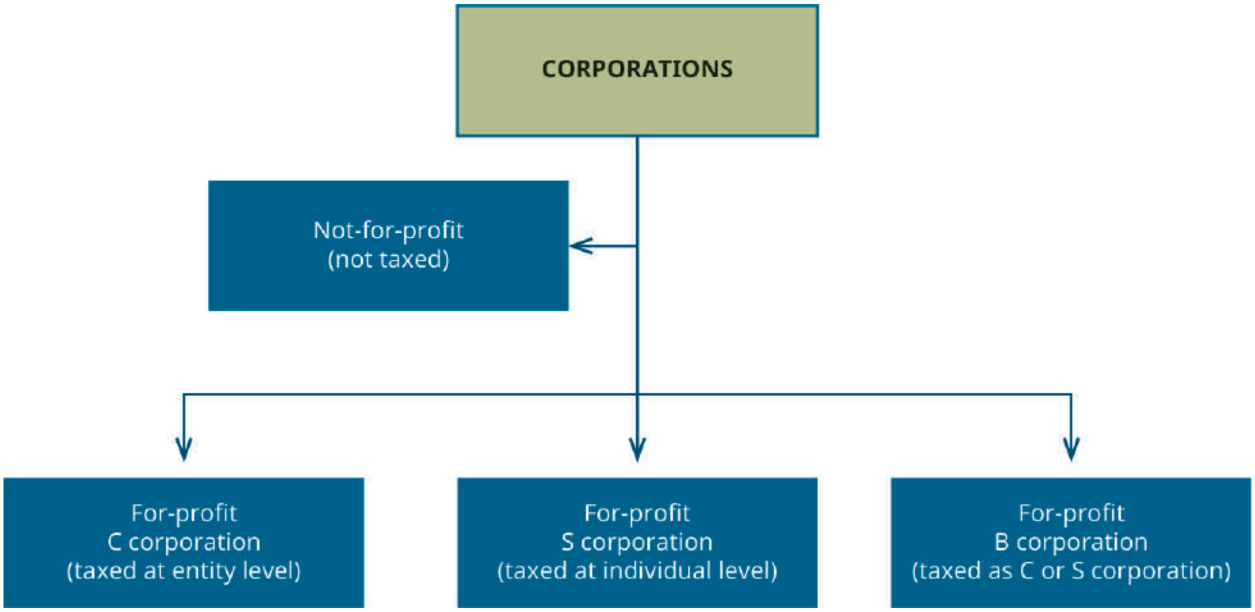

Figure 13.6 C corporations, S corporations, and B corporations are all types of for-profit corporations, in contrast to a not-for-profit corporation. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

ARE YOU READY?

B Corporation Certification

The B corporation website explains the process for becoming a B corporation. This involves three specific steps: Verified Performance, Legal Accountability, and Public Transparency. Go to https://bcorporation.net/about-b-corps and read about B corporations to learn what requirements they need to meet to be allowed to display the following B corporation logo shown in Figure 13.7.

Figure 13.7 In order to become a certified B corporation, a company must go through an external audit of compliance with each of the requirements of the B corporation. (credit: modification of "Runa B Corp Label" by "Lelepanne"/Wikimedia Commons, CC0)

Privately Held versus Publicly Held Corporations

Terminology relating to whether a company is publicly or privately owned can sometimes be confusing. For example, large corporations such as Exxon or Amazon are private corporations, but their stock is publicly held. This means that any member of the investing public can own stock in the corporation. A true **public corporation** is, in reality, a quasi-governmental entity, an entity owned or sponsored by the government. Government-owned corporations include the US Postal Service, the Corporation for Public Broadcasting, AmeriCorps, and Amtrak. Government-sponsored corporations include Freddie Mac and Fannie Mae, mortgage-related entities. A **privately held corporation**, common in Europe, is a company that does not allow members of the investing public to own stock. The founder’s family or friends, or perhaps a private group of investors such as a venture capital firm, may hold it. Examples include Facebook before it went public in 2012, or Cargill or Mars.

Publicly Traded Corporations

A **publicly held corporation** is, as described, an entity in which members of the investing public own the stock. A term commonly applied to such corporations is a *publicly traded corporation*, meaning that the stock can be bought and sold in the public marketplace, such as the New York Stock Exchange. A publicly traded corporation has more access to investors and thus more capital, but it must operate under a formal set of rules established by the Securities and Exchange Commission and Congress, assuming the shares are sold publicly in the United States. Audits of publicly traded companies also have to follow the rules of the Public Company Accounting Oversight Board (PCAOB). “The PCAOB oversees the audits of public companies and broker-dealers in order to protect investors and the public interest by promoting informative, accurate, and independent audit reports.”[8] Following the SEC and PCAOB rules emphasizes investor protection but can be complex, as it increases both startup and operating costs for the venture due to increased regulation and reporting.

A publicly traded company is required to have a board of directors with a dual mandate to both consult with management regarding the strategic direction of the company and oversee company performance. The board of directors does not manage the company, and the members are separate from management.[9] The board will have numerous committees to assist in its functionality, and one of the committees is the audit committee. The audit committee of a publicly traded company must hire an outside auditor approved by the PCAOB to audit the books of the publicly traded company. Further, the chief executive office and chief financial officer of the publicly traded company must sign a certification of earnings report, guaranteeing their truthfulness. The rules and regulations with which compliance is required are more demanding for a publicly traded company than for a privately held or closely held company.

Closely Held Corporations

A closely held corporation, also known as a close corporation, is the same as a privately held corporation for the purposes of securities laws. However, the concept has a secondary meaning related to management structure. A close corporation is also a management structure for a corporation that is often selected by small companies that use the less-formal management style of a general partnership yet retain the limited liability of a corporation. In essence, there are fewer formalities for a close corporation, and it allows greater control for the small group of shareholders.

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8 PCAOB. “Protecting Investors Through Audit Oversight.” n.d. https://pcaobus.org/

9 Stanford Business Graduate School: Corporate Governance Research Initiative. *Board of Directors, Duties and Liabilities*. n.d. https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-quick-guide-03-board-directors-duties-liabilities.pdf

A close corporation is required to have an annual shareholder meeting and keep corporate minutes. All of this detail is required to be recorded in the corporate records, even if there is just one shareholder. Sole proprietors using a corporation as a business structure must follow the rules regarding corporations in the state in which they were incorporated. Some states may even dissolve a corporation that does not have an annual meeting or keep proper corporate records. When a corporation is dissolved, the shareholders become personally liable for corporate debts, and shareholders' limited liability is lost. Managing a closely held company requires the entrepreneur to follow state guidelines while operating the corporation accordingly.

The shares of a closely held corporation are not traded on the open market and typically have just a few shareholders. Closely held corporations have fewer reporting requirements than publicly traded companies and typically are not required to have audited financial statements, unless the corporate charter says otherwise. Audited financial statements are costly and are required for publicly traded companies. The audited financial statements help investors buying and selling stock in the stock market value shares and are not necessarily needed for a closely held corporation. However, it is difficult to value a closely held corporation because there is no ready market for the ownership shares.

Not-for-Profit Corporations

Nonprofit corporations are created in one a state but may operate or solicit donations in other states. A nonprofit corporation operating or soliciting donations in multiple states needs to register to operate as a nonprofit corporation in every state in which it operates.

Not-for-profit corporations are organized in a similar fashion to for-profit corporations, with a board of directors and officers, but they have no shareholders, stock, or owners. The stakeholders of a non-for-profit corporation play an important role, monitoring overhead and allocation of funds. Since most of the funds are donations and are tax deductible, public watchdogs may monitor the financial statements of federally tax-exempt organizations. The fact that the Internet provides easy access to financial data related to federally tax-exempt nonprofits provides watchdog organizations easy access to financial data and the ability to analyze the operations and compensation for the nonprofit's organizers and employees.

ENTREPRENEUR IN ACTION

Bombas: Achieving Profit and Nonprofit Goals

In a 2017 interview with Robin Roberts of ABC News, Bombas socks (Figure 13.8) co-founder David Heath said: "Back in 2011, I came across a quote on Facebook that said…that socks were the number one most requested clothing item in homeless shelters."[10] So he decided to start a new company that was an overnight success, boosted by an appearance on *Shark Tank* in 2014. He created his company, Bombas, with co-founding entrepreneur Randy Goldberg. They founded their company with the goal of giving back to the community by donating socks to the homeless, with its actual product idea as a secondary goal.[11] They have donated over 25 million items through more than 2,500 partners across the country.[12]

10 ABC News. "Q&A: Entrepreneurs behind the Socks Company Bombas Share Their Career Advice." August 2, 2017. https://abcnews.go.com/Business/qa-entrepreneurs-socks-company-bombas-share-career-advice/story?id=48954057

11 Mara Leighton. "B Corps Are Businesses Committed to Using Their Profit for Good—These 12 Are Making Some Truly Great Products." *Business Insider*. June 6, 2019. https://www.businessinsider.com/b-corp-charitable-business-2018-8?IR=T&r=US

12 Bombas. "Giving Back." n.d. https://bombas.com/pages/giving-back

Figure 13.8 This is a pair of Bombas socks. (credit: modification of "Bombas Socks" by Tony Webster/ Flickr, CC BY 2.0)

Bombas is now a successful sock company that uses a business entity as a way to address the shortage of sock donations in homeless shelters. Heath and Goldberg spent two years inventing pairs of high-quality socks with extras such as reinforced foot beds and anti-blister tabs, coupled with contoured seaming. For these entrepreneurs though, it was not just about sock technology, it was about doing something meaningful at the same time—a combination of profit and nonprofit goals. Therefore, they made a commitment to those in need, and since 2013, the company has donated more than 10 million pairs of socks to homeless shelters, due to their buy one, give one model of marketing socks.

The socks that Bombas donates to the homeless are not cheap throw-away token socks. Rather, they have been designed for their homeless wearers, for example, with antimicrobial treatment to prevent bacteria if they cannot be washed as frequently and reinforced seams for durability, since the homeless do not have the money to keep buying new ones.[13]

In essence, the company makes customers, and the company partners with the homeless.

- Is Bombas really paying for this project to help the homeless or is the customer?
- Is Bombas just facilitating the good idea and customers are paying for it, or do you think Bombas is also contributing some of its profit?

LINK TO LEARNING

Go to the Bombas website (https://openstax.org/l/52Bombas) to watch the video that explains what they do as part of their B corporation commitment.

13 Mara Leighton. "B Corps Are Businesses Committed to Using Their Profit for Good—These 12 Are Making Some Truly Great Products." *Business Insider*. June 6, 2019. https://www.businessinsider.com/b-corp-charitable-business-2018-8?IR=T&r=US

Overview of Corporate Taxation

All for-profit corporations are subject to income tax at the federal level, and usually at the state level as well. Regardless of tax elections, both C- and S corporations are subject to taxation.

Tax planning is a major issue for most corporations and may explain some key decisions, such as where they are located. That could involve decisions about which state the corporate headquarters are in, or even in which nation the headquarters are located. This is because tax laws may vary significantly by both state and nation.

The current federal income tax rate for corporations in 2019 is 21 percent, down drastically from 35 percent, which was the rate prior to 2018. Many states add a state-level income tax, ranging from 2 percent to 12 percent, while some states such as Texas do not have a corporate income tax in an effort to attract corporations to the state.[14]

Taxation of C Corporations

C corporations pay corporate income taxes on profits made. Individual shareholders are also subject to personal income taxes on any dividends they receive. Most attorneys and accountants refer to this concept as the double taxation disadvantage. However, the historical tax disadvantage has been recently reduced because of the decrease in the income tax rate paid by C corporations by the Tax Cuts and Jobs Act.[15] This decrease, in turn, reduces the double tax disadvantage. Further, the ability to retain and reinvest profits in the company at a lower corporate tax rate is an advantage.

A C corporation does come with a degree of added formality, or as some may refer to it, red tape. According to most states' corporation laws, as well as federal tax and securities laws, the corporation must have company bylaws and must file annual reports, financial disclosure reports, and financial statements. They must hold at least one meeting each year for shareholders and directors where minutes are taken and maintained to display transparency. A C corporation must also keep voting records of the company's directors and a list of the owners' names and ownership percentages.

Despite the tax implications, the C corporation structure is the only one that makes sense for most large US businesses because it allows for the wide-scale sale of a large amount of stock to the general investing public without limits. A C corporation can have an unlimited number of shareholders that are individuals or other business entities, and are either US citizens or foreign nationals.

Taxation of S Corporations

As previously discussed, the S corporation is a corporate entity in which the firm's profit is passed through its stockholders (shareholders), usually in proportion to their investment—this is known as pass-through taxation. Essentially, this amounts to tax management by the corporate owners. The IRS taxes the corporate profits at the personal income tax rates of the individual shareholders. S corporations (S stands for "small"), also called subchapter S corporations, must comply with several important restrictions with which entrepreneurs must comply.

S corporations have a limit on shareholders. Unlike with C corporations, the Internal Revenue Code limits the number of S corporation shareholders to 100 or fewer, and owners can only be individuals, (or estates and certain types of tax-exempt entities). Additionally, the individual shareholders must also be US citizens or legal permanent residents. Furthermore, S corporations may only have one class of stock, whereas C corporations

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14 Tax Foundation. "State Corporate Income Tax Rates and Brackets for 2019." 2019. https://taxfoundation.org/state-corporate-rates-brackets-2019/

15 US Internal Revenue Code of 1986. 131 Stat. 2054.

may have multiple classes. For example, in a C corporation, there might be voting shares, nonvoting shares, common shares (the type most people buy), and preferred shares (which are repaid first in the event of bankruptcy).

13.3 Partnerships and Joint Ventures

Learning Objectives

By the end of this section, you will be able to:

- Describe the ownership structure of a partnership
- Describe the ownership structure of a joint venture
- Summarize the advantages and disadvantages of partnership and joint venture structures

A **partnership** is a business entity formed by two or more individuals, or partners, each of whom contributes something such as capital, equipment, or skills. The partners then share profits and losses. A partnership can contract in its own name, take title to assets, and sue or be sued.

A **joint venture** is, in essence, a temporary partnership that two businesses form to gain mutual benefits, such as sharing of expenses and to work toward shared goals and the associated potential revenue. Joint ventures share costs, risks, and rewards. A joint venture, for example, can help speed up expansion of your business by gaining access to additional equity, new markets, or new technology. Partnerships and joint ventures share many similarities, but they do have some important differences.

Overview of Partnerships

State law governs the formation and operation of all partnerships. It would be too lengthy to cover the laws of all fifty states; therefore, this section contains some generalizations that may vary according to jurisdiction. Federal law has very limited applicability to partnerships, primarily in the area of federal income taxation. A **general partnership** is created when two or more individuals or entities agree to work together to operate a business for profit. A partnership generally operates under the terms of a written partnership agreement, but there is no requirement that the agreement be in writing. In many instances, the only requirement is that two or more parties come together to operate a business for profit.

Entrepreneurs need to be careful because a general partnership can be informally created by the actions of two or more people or entities pursuing a business for profit while sharing management duties. State courts may deem these actions the creation of an informal or even formal partnership. For this reason, if two entities or people come together to purse a joint business operation or strategy, the parties should document the pursuit of the business venture in a written agreement. Many state laws require that some forms of a partnership use a formal written partnership agreement or articles of partnership. If the venture is of a shorter duration, it might be better to enter into an agreement documenting a joint venture. In either case, the entrepreneur needs to have a clear understanding of the exact business relationship before embarking on a new venture, and a partnership agreement can and should outline those details.

A partnership agreement addresses many important topics, including the monetary investment of each partner, their management duties and other obligations, how profits or losses are to be shared, and all the other rights and duties of the partners.

Partnerships can take many forms, including general partnerships (GPs), limited partnerships (LPs), limited liability partnerships (LLPs), and, in some states, limited liability limited partnerships (LLLPs). All states require the registration of any limited liability entity. In GPs, liability of the owners is considered “joint and several,” meaning that not only is the partnership entity liable, so too is each general partner.

The liability of partners, therefore, may be limited by the creation of an LP. A **limited partnership** requires at least one general partner and one or more limited partners. A limited partner’s liability is typically capped at their investment, unless they take on the duties of a general partner. The general partner is personally liable for all of the operations of the LP.

LPs have been around for many years and allow investors to provide funding for a business, while limiting their investment and personal risk. LPs are commonly used in businesses that require investment capital but do not require management participation by LP investors. Examples include real estate where the LP buys commercial real estate, making and funding movies or Broadway plays, and drilling oil and gas wells.

Some states have relatively recently started to allow variations on the LP structure and offer businesses the option of forming a related type of partnership entity. These **limited liability partnerships** are common with businesses such as law firms and accounting firms. The partners are licensed professionals, with limited liability for financial obligations related to contracts or torts, but full liability for their own personal malpractice. The primary difference between LLCs and LLPs is that LLPs must have at least one managing partner who bears liability for the partnership’s actions. An LLP’s legal liability is the same as that of an owner in a simple partnership. Entities that are formed with a founding partner or partners—commonly law firms, accounting firms, and medical practices—often structure as an LLP. In this situation, junior partners typically make decisions around their personal practice but don’t have a legal voice in the direction of the firm. Managing partners may own a larger share of the partnership than junior partners.

The final type of partnership is a limited liability limited partnership (LLLP), which allows the general partner in an LP to limit their liability. In other words, an LLLP has limited liability protection for everyone, including the general partner who manages the business.

Advantages and Disadvantages of General Partnerships

The GP is a very common business structure in the US. It is created when two or more individuals or entities come together to create, own, and manage a business for profit. A GP is not technically required to have a written agreement, or to file or register with the state government. However, GPs should have their business structures described in writing, so that the entities working together have an understanding of the business and the business relationship.

When a GP is created, one partner is liable for the other partner’s debts made on behalf of the partnership, and each partner has unlimited liability for the partnership’s debt. This creates a problem when one partner disagrees with the source or use of funds by another partner in terms of capital outlay or expenses. Each partner in a GP has the ability to manage the partnership; if something negative happens such as an accident (called a tort) that injures people and produces liability—like a chemical spill, auto accident, or contractual breach—each of the partners is personally liable with all of their personal assets at risk. Also, the partners are liable for the taxes on the partnership, as a GP is a pass-through entity, where the partners are taxed directly, but not at the partnership level.

It should be noted that GPs may be a useful structure in certain situations because they are relatively easy and inexpensive to form. The expanding use of LPs, LLPs, and LLLPs is discussed in the preceding text, but the popularity of GPs has been on the decline. However, as long as the business does not have a high likelihood of liability-producing accidents or situations, a GP can work. An example might be two partners offering graphic design or photographic services. However, due to the different risks associated with them, GPs are often not the best choice of business entity. Other types of entities offer the protection of limited liability and are thus better choices in most circumstances.

Taxation of Partnerships

Partnerships are considered pass-through entities, whether they are GPs, LPs, or LLPs. Therefore, the partnership's profits are not taxed at the entity level, like with a C corporation, but the profits are passed through to the partners, who claim the income on their own tax returns. The partners pay income taxes on their share of distributed partnership profits (disclosed on a Schedule K-1 form from the partnership to the individual partners). Thus, there is no such thing as a partnership tax rate.

If the entity is a joint venture that is organized and run as a partnership, then it is taxed the same way, even if the partners are corporations. The profits are distributed, and each corporation pays its own taxes. If, in the alternative, the joint venture formed a separate distinct corporation, then it pays taxes as a corporation.

LINK TO LEARNING

See the University of Richmond Law School's good summary of the pros and cons of GPs (https://openstax.org/l/52URichLawGP) to learn more.

Joint Ventures: Business Entities Doing Business Together

A joint venture occurs when two or more individuals or businesses agree to operate a for-profit business venture for a specific purpose. A joint venture is similar to a legal partnership but different in terms of purpose and duration. Usually, joint ventures are used for a single purpose and a limited period. One example of a joint venture involved BMW and Toyota working together to research how to improve the batteries in electric cars, a single purpose, over a period of limited duration, envisioned to be ten years.

Companies enter into a joint venture often to avoid the appearance of the creation of a partnership, because partnerships tend to create long-term obligations between the partners, while a joint venture is a limited business enterprise. Typically, two business entities operate a business together on a joint project. The joint venture agreement allows the entities to pursue a specific business objective while keeping their other business operations and ventures separate.

A joint venture is not recognized as a taxable entity by the IRS. The entrepreneur can use a joint venture agreement to develop a business enterprise, and if the business enterprise is successful, a new entity can be created to take over the operations of the joint venture and move the business to the next level. For this reason, a joint venture can be a good way test a business concept. If successful, then the operations and assets can be rolled into another entity that supports investment from outside investors. The use of a joint venture also allows the parties to test drive the relationship between the entities: to develop a business venture with less risk.

Joint ventures can involve parties that are large or small, or from private or public sectors, or they can involve a combination of types of entities, most often resulting in a joint venture that is formed as a corporation or LLC. For example, the public company Google and the private entity NASA formed a joint venture to improve Google Earth. Likewise, a joint venture might be something smaller, such as an arrangement between a freelance IT engineer, a graphic designer, and a social media consultant to create a new cell phone app. Figure 13.9 summarizes the relationships of the businesses in a joint venture.

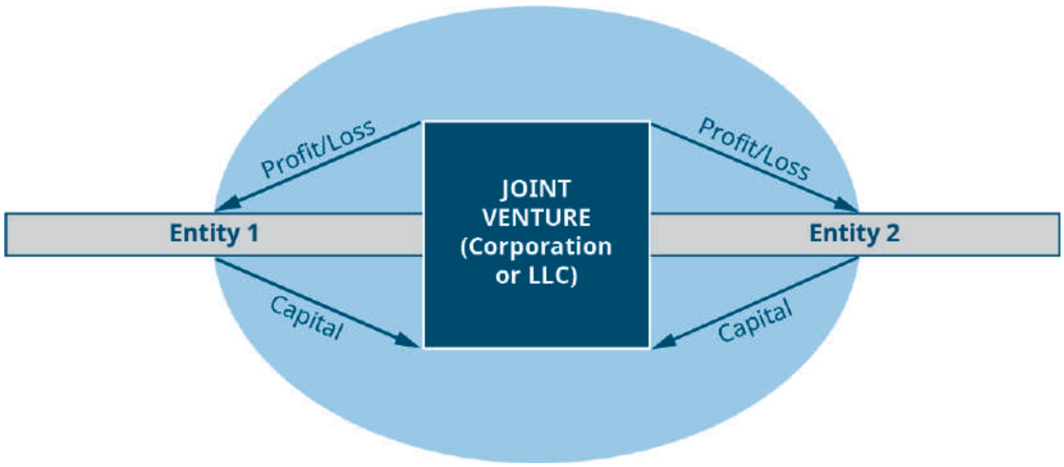


Figure 13.9 Joint ventures are separate business entities, most often owned and operated by two other business entities. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

WHAT CAN YOU DO?

Challenges Facing Small Farmers

Sometimes, small businesses are at a disadvantage due to size. We can see an example of this disadvantage in the field of agriculture. The cost of new agricultural equipment is very high, and land may be prohibitively expensive. These costs put small farms under pressure to compete by increasing the size of their operations. If you owned a small farm and were looking to expand, how could you use a joint venture?

13.4 Limited Liability Companies

Learning Objectives

By the end of this section, you will be able to:

- Describe the ownership structure of a limited liability company
- Explain how limited liability companies are taxed
- Summarize the advantages and disadvantages of the limited liability company structure

A **limited liability company** is a hybrid of a corporation and a partnership that limits the owner's liability. The big advantage that LLCs have over GPs is in the protection of owners from personal liability. Thus, an LLC is similar to a corporation in that it offers owners limited liability.

The advantage that LLCs have when compared to corporations, especially for entrepreneurs, is that they are easier to form and less cumbersome to operate because there are fewer regulations and laws governing LLC operations. Although LLCs tend to be easier to create, they still require a filing of articles of formation with the state and the creation of an operating agreement. Owners of an LLC can be individuals and other business entities. The entrepreneur can use the flexibility of an LLC to create a business structure suitable to the operational and tax needs of the business.

In 1977, Wyoming was the first state to allow the LLC format—most states started allowing them in the early 1990s. In contrast, corporations have been around since the early nineteenth century. LLCs now significantly outnumber corporations, with some estimates indicating that four times as many LLCs are formed as corporations,[16] with the total number of LLCs nearing 20 million compared to about 2 million corporations. Each state may permit varying types of LLCs, with different types of formation agreements and operating agreements.

When evaluating the use of an LLC as the structure for your business, it is important to know that there are some constraints on the use of an LLC. In most states, a nonprofit business cannot be an LLC. Additionally, most states do not permit banks or insurance companies to operate as LLCs.

Overview of LLCs

The owners of an LLC are called members. The owner (if a single-member LLC) or owners often run the company themselves. These are called member-managed LLCs. The daily operations of the LLC can also be delegated to a professional manager, which is called a manager-managed LLC. If the original organizer of the LLC chooses, they can organize an LLC in which the owners (members) will have little or no management responsibility because it has been delegated to a professional manager. These options when drafting an LLC's operating agreement allow an LLC to operate in different ways, so that an entrepreneur can develop a business structure best suited to the needs of the business.

As long as the members (owners) do not use the LLC as an alter ego and/or commingle personal funds with LLC funds, the LLC provides the corporate shield of limited liability to the investors. If the LLC is operated to protect a sole proprietor, this might become an issue if the sole proprietor commingles funds. Commingling funds or assets gives rise to the sole proprietor or other members of a multi-owner LLC being liable for all of the debts of the LLC. Generally, the ownership of an LLC is represented by percentages or units. The term *shares* is not used in operating agreements because LLCs cannot sell shares of stock like a corporation can; thus, owners are not technically shareholders.

Taxation of LLCs

Entrepreneurs are able to make decisions regarding the taxation of LLCs. The government can tax the business as a corporation or as an individual. This choice may involve more than simply a tax rate decision; it might involve ownership and management issues, as well other financial considerations. However, this section will focus on the tax decision aspect of the issue.

A multi-owner LLC's default taxation is as a partnership, meaning profits pass through and are taxed on the

16 Scott A. Hodge. "The U.S. Has More Individually Owned Businesses Than Corporations." *Tax Foundation*. January 13, 2014. https://taxfoundation.org/us-has-more-individually-owned-businesses-corporations/

owner's federal tax return. However, LLCs can elect to be taxed as either a partnership or a corporation. Single-member LLCs can also be taxed as a sole proprietorship or as a corporation. The fact that an LLC can select its method of taxation as either a C corporation, S corporation, or partnership allows the entrepreneur flexibility in creating the business structure of their choosing. Note, however, that tax laws change. For example, the Tax Cuts and Jobs Act of 2017 may make formation as an S corporation more attractive to some entrepreneurs than formation as an LLC, at least as far as taxation is concerned. You should seek advice from a tax accountant to ensure that you are able to make decisions based on the most current regulations.

13.5 Sole Proprietorships

Learning Objectives

By the end of this section, you will be able to:

- Describe the ownership structure of a sole proprietorship
- Explain the advantages and disadvantages of operating as a sole proprietor

A **sole proprietorship** is a business entity that is owned and managed by one individual and has very little formal structure and no mandatory filing/registration with the state. This type of business is very popular because it is easy and inexpensive to form. The owner, called a sole proprietor, is synonymous with the business and is therefore personally liable for all debts of the business. Sole proprietors do not pay separate income tax on the company, instead reporting all losses and profits on their individual tax returns.

Overview of Sole Proprietorships

Entrepreneurs solely operating their own businesses are called sole proprietors. According to the Tax Foundation, there are more than 23 million sole proprietorships in the US, far more than any other type of business entity.[17] This statistic means that the sole proprietorship is by far the most common business structure, even though the business is not legally separate from its owner. The primary reason that many entrepreneurs choose the sole proprietorship format is that they do not have to make a choice, get professional advice, or spend any money. An entrepreneur who just starts doing business is automatically a sole proprietorship unless they elect to become a different type of entity and file that paperwork. An entrepreneur who becomes a sole proprietor does not necessarily have to go to an attorney or an accountant, or file any documents, making a sole proprietorship quick, easy, and cheap to form and operate.

Another development related to the decision to be a sole proprietor is the rapid growth of the gig economy. Some individuals prefer to work on their own rather than become a full-time employee. Being a gig worker falls somewhere between being a business owner and being an employee, so many gig workers, ranging from drivers for a ride-sharing company to instructional designers, operate as de facto contractors who are sole proprietors.

However, there remains a debate about whether these gig workers should be deemed sole proprietors. Recently, California passed a new law, signed by Governor Gavin Newsom, which extends wage and benefit protections to many thousands of workers who were previously self-employed sole proprietors working in the gig economy. The new law is based on the presumption that when workers are misclassified as independent

17 Scott A. Hodge. "The U.S. Has More Individually Owned Businesses Than Corporations." *Tax Foundation*. January 13, 2014. https://taxfoundation.org/us-has-more-individually-owned-businesses-corporations/

contractors rather than as employees, they lose basic benefits such as a minimum wage, paid sick days, and health insurance.

The sole proprietorship is the simplest method to operate a business—often under the owner's name—and the owner is typically taxed directly by the IRS by attaching a Schedule C (Profit or Loss) form to the owner's individual tax return. In order to document one's income, instead of being provided a Form W-2 from one's employer, many self-employed individuals receive one or more 1099-MISC (Miscellaneous Income) forms from clients, which typically demonstrate that the taxpayer is operating a sole proprietorship. Sole proprietors are allowed to deduct their business expenses related to their income and, as both employer and employee, are required to pay the full amount of employment taxes for Social Security and Medicare.

An owner can also operate under a DBA or "doing business as" filing. A DBA is filed at the relevant state or local government office where the sole proprietor wants to operate under an assumed name. Technically, this is not a new organization: It is just a different name. Any business entity may file for a DBA to operate under an assumed name, and many individuals operate under a DBA to indicate the type of services they are providing, such as Smith's Roofing Company. It is not uncommon for an individual to name a sole proprietorship using LLC or Co. in its name; however, an individual operating under a DBA or assumed name is not provided any of the protections provided to a corporation of LLC, even if Inc. or LLC is used in the assumed name. A sole proprietor needs to consider the impact of using an assumed name prior to creating a DBA.

Advantages and Disadvantages of Sole Proprietorships

The sole proprietor is personally liable for everything. A sole proprietor is the investor, owner, and manager of the business enterprise. The sole proprietor is personally liable for all of the taxes and any unpaid debts of the business venture. The sole proprietor also has no business to sell and can sell only assets related to the business. The sole proprietorship is the easiest business to start but has almost no differentiation from the individual starting the business.

Taxation of Sole Proprietorships

A sole proprietorship is not taxed as an entity. All profits pass through to the owner who pays individual income taxes on all profits earned. It does not matter whether the owner takes the money out of the business or leaves it in the business; all profits are taxed to the individual owner. This is an area that requires significant planning and may be a potential disadvantage, depending on how the individual owner's personal rate compares to the corporate rate.

Other Low-Risk Entry Structures in Entrepreneurship

Over the past decade, various alternatives to traditional employment have become popular, leading many to become entrepreneurs rather than employees. The US Bureau of Labor Statistics reported that, in 2019, there are 55 million people in who are "gig workers," which is more than 35 percent of the US workforce. That percentage is expected to increase to 43 percent by 2020.[18] This offers both an opportunity and a challenge. There is a modicum of security when one is an employee of a company, which may not exist in the same way for someone who is freelancing or working as a contractor. There are many examples today of people becoming small entrepreneurs. This process goes by a variety of names, such as the sharing economy, the gig

18 Quora. "What Are the Pros and Cons of the Gig Economy?" *Forbes*. January 8, 2019. https://www.forbes.com/sites/quora/2019/01/08/what-are-the-pros-and-cons-of-the-gig-economy/#3e1dc24e1388

economy, the peer economy, or the collaborative economy. Maybe it means driving for a company such as Lyft, Uber, or GrubHub, or perhaps offering services through TaskRabbit, UpWork, or LivePerson.

ARE YOU READY?

Online Resources for the Gig Economy

The website business UpWork provides a platform for individuals to offer their services to large companies on a freelance or contract basis. Do you have skills as a web, mobile, or software developer, or perhaps in the area of data analytics? The UpWork website (https://openstax.org/l/52UpWork) says that over 5 million businesses use people listed on UpWork, including companies such as Microsoft and General Electric.

Offering your services in this new manner is not controlling of what type of entrepreneurial enterprise you want to be. You can do most of these types of things as a sole proprietor, an LLC, or an S corporation. According to the Tax Foundation, over the past thirty-five years, the number of C corporations has declined significantly, while the total number of pass-through businesses including LLCs, S corporations, partnerships, and sole proprietorships has tripled to over 30 million. According to estimates, there are only 1.7 million C corporations, whereas there are 7.4 million LLCs, partnerships, and S corporations, and a whopping 23 million sole proprietorships.[19] The explanation for these statistics is really quite simple. LLCs have quickly become one of the most popular business structures due to ease of formation and operation. Likewise, sole proprietorships are quick, easy, and low cost compared to corporations, which are more difficult and expensive to form and operate. The choice is open and depends on the variables discussed in this chapter.

ENTREPRENEUR IN ACTION

Nic & Luc Jam[20]

In an interview with the Balance, entrepreneur Leroy Bautista summarized his path to becoming a small business owner. He worked in high-end restaurants and successful catering companies for two decades before he was laid off during the economic downturn. Bautista didn’t sulk or settle for a lousy job. Rather, he saw it as a chance to finally do what his coworkers and friends had been telling him to do: go out on his own, making his sauces and vinaigrettes, and selling them at local markets. It was out of necessity that the Nic & Luc company was born.

Originally selling just a few flavors, he now sells almost twenty flavors. For many small businesses, the word “local” is used as a marketing ploy, but for Nic & Luc, it is part of the business purpose and a core value. Bautista thinks it is important to support other local businesses like himself.

This is not a story that someone like Bezos or Gates might tell: It is much more basic, but it demonstrates how people at all levels are becoming business owners. Each one of them, including Leroy Bautista in this

19 Scott A. Hodge. “The U.S. Has More Individually Owned Businesses Than Corporations.” *Tax Foundation*. January 13, 2014. https://taxfoundation.org/us-has-more-individually-owned-businesses-corporations/

story, must make decisions about mundane things such as taxes, and liability; it can't be all about jam.

13.6 Additional Considerations: Capital Acquisition, Business Domicile, and Technology

Learning Objectives

By the end of this section, you will be able to:

- Describe the capital acquisition opportunities available to different types of business structures
- Explain how the advantages and disadvantages of where a business is registered should inform the decision of where to create a business domicile
- Understand the role technology considerations may play in selecting a business structure

In addition to the main entity selection topics already discussed, such as ownership structure and taxation, there are other considerations that entrepreneurs might want to consider. For example, when choosing a business format, a founder would be interested in how to raise capital to use in the business.

Another issue to consider includes where to form a new business, since formation is largely a state issue, and there are fifty different states from which to choose. This has the potential to affect multiple aspects of one's business, including income and sales tax issues, government regulation, and litigation situs (location). For example, some states, such as Wyoming and South Dakota, have no corporate income or gross receipts tax at all; other states, such as California and New York, do have a state corporate income tax. For more information on the variation between all 50 states, see the following website operated by Cornell Law School: https://www.law.cornell.edu/wex/corporations.

Capital Acquisition

Once an entrepreneur has created a business plan, the next requirement is to capitalize the business venture. If the entrepreneur wants to start out small, a sole proprietorship is all that is needed, although even for small businesses, this structure carries a high degree of risk. Basically, the entrepreneur can simply start working on the business venture. If the entrepreneur's business venture is larger, raising capital becomes a major issue. This can be done though bank loans or investors.

Entrepreneurs eventually need capital to grow their business. Capital typically comes in the form of cash. Entrepreneurs need to consider the business structure they select for raising cash in the future if they plan to grow their business. Banks, family members, friends, or others can lend cash to an entrepreneur. These types of loans may not give the lenders ownership rights in the company. The lenders may take a lien on the assets of the business venture but do not necessarily have the right to run the business. Management is typically left to the owners when borrowing funds, but when a company receives investment funds, the investor also receives an equity share in the business and may be involved in management.

Owners and investors may want to have the right to operate the business or may want the investment structured in such a fashion so that the investors only participate in the profits or losses of the business, but

20 Alton, Larry. "4 Small Business Success Stories for New Entrepreneurs." *The Balance Small Business*. February 5, 2019. https://www.thebalancesmb.com/small-business-success-stories-to-learn-from-4151885

do not operate the business. Depending upon the type of the business and the expectations of the entrepreneur and possible owners, this needs to be considered before creating a company. An entrepreneur raising capital needs to consider what participation is desired from investors and the timing of the needed capital. Remember, investors become owners, whereas lenders are not owners.

Capital is required at every step of a business. There can be lines of credit to finance operations as receivables are collected, and there can also be long-term borrowing for purchases of big-ticket assets required to operate the business. The difference between a loan and an investment is that the loan principal and interest must be paid back. However, an investment allows the investor to participate in the profits and losses of the business, but does not need to be repaid because investors can get a return on their investment by selling their interest in the business. Finding a good balance between how much ownership the entrepreneur wants to relinquish versus how much of the profits need to be paid to finance the business is key. The entrepreneur needs to determine this balance as the company grows. For example, Amazon started as a Washington state corporation named Cadabra, Inc., operating out of Jeff Bezos' garage, and then through several transactions became the world's largest online retailer incorporated as a Delaware corporation with its ownership shares AMZN traded on the NASDAQ.

Growing companies will have different rounds of outside investment. Never consider that the first outside investment received will be the last investment. There will be more than one round of financing in most companies. As the investment and financing changes, there will be changes in the corporate structure of the business venture. Just like Amazon, a company can start in one's garage and then go on to be a company listed on a major stock exchange with a worldwide reach. Each step of the way takes careful planning (see Entrepreneurial Finance and Accounting).

Legal and tax issues are directly related to the agreements between entrepreneurs and their investors. The written agreements should spell out the corporate structure with specific details of the arrangement between the two. The business structure will drive the tax circumstances of the investment, business, and owners. This may change with new investors, so agreements should be flexible. Many times, a new investment in the same business may be created in which the new business structure purchases the assets of the old business structure. This event will change all of the agreements evidencing the structure of the venture.

Agreements describing how the owners share in profits and losses, and how the owners share in making decisions about the business venture can and do change. Many owners and entrepreneurs desire that their company become a publicly held corporation. This is a company with its ownership shares traded on a public exchange. The ease of buying and selling shares on a public exchange typically increases the value of the company. Therefore, many investors desire that shares ultimately become publicly traded. A company may start as a sole proprietorship, become an LLC, and then be converted into a corporation with its ownership shares traded on a public stock exchange. In the circumstance where the company is growing, the business structure will change over time.

Many publicly traded companies start as a privately held corporation before going public through an initial public offering (IPO). A recent example is Spotify, which in a 2018 IPO raised $9.2 billion.[21] A closely held corporation, which is essentially the same as a privately held company, has no public market for its stock. The owners, as members or shareholders, have more control over the directions of the company, until the company is taken public.

The assets of a closely held company can be sold to a company that is publicly traded, such as a reverse

21 Samuel Stebbins. "The Top 26 Largest Company IPOs of the Year." *USA Today*. December 7, 2018. https://www.usatoday.com/story/money/business/2018/12/07/top-ipos-2018-26-biggest-companies-went-public-year/38611947/

merger, or can be used to create a company that will pursue an IPO. Both of these are complicated endeavors that require audited financial statements, the assistance of lawyers and outside accountants, and the use of an investment bank. Each step of the way, the entrepreneur gives up some equity and control in the company in exchange for investment money to help the company grow. Most small companies becoming public will (but are not required to) list on a stock market like the Nasdaq SmallCap market or the Nasdaq National Market System. This development provides the company direct access to international capital markets and many new investors.

The issues that investors tend to look at include transferability or sale of their ownership interest, ability to raise additional capital, and protection of the investors' assets outside of the investment. If the entrepreneur is unconcerned about investment from outsiders, these considerations are not as important. Another issue is the ability to raise capital through banks or by using the SBA to guarantee a loan through a participating bank. The first step in getting an SBA loan is determining that the "business is officially registered and operates legally."[22] This means that the borrowing business is a company that is registered in a state to do business. An entrepreneur can borrow up to $4.5 million (the SBA limit[23]), to fund operations. However, the first step is to create a proper business entity to which the bank can loan the money or in which an investor can invest. The typical entities to which banks lend money and investors invest money are partnerships, LLCs, or corporations. To create these entities, an entrepreneur needs to file the appropriate paperwork within a given state.

In addition to traditional sources of funding, including borrowing, taking on partners, and selling stock through an underwriter, there is a relatively new source of capital for small business entrepreneurs that is an important addition to the capital acquisition options for startups. **Equity crowdfunding** involves a startup raising capital through the online sale of securities to the general public.

In 2012, Congress enacted new legislation called the Jumpstart Our Business Startups (JOBS) Act, which amended US securities laws to enable small businesses to use a variation on a technique known as crowdfunding (see Entrepreneurial Finance and Accounting). Crowdfunding is already in use as a way to donate money to consumers and businesses through web portals such as GoFundMe, but those sites do not offer SEC-compliant sales of securities in a business, as the JOBS Act now permits. Emerging growth companies (EGCs) seeking capital are now able to raise equity capital more easily and at a lower cost. This new type of funding should help level the playing field for EGCs and is viewed by many as a way of democratizing access to capital.

An example of success using this new method of financing for entrepreneurial startups is Betabrand. This San Francisco-based retail clothing company doubles as a crowdfunding platform. The company facilitates the use of its platform for crowdsourcing clothing concepts and prototypes, and their conversion into actual products by raising capital through their website.

LINK TO LEARNING

The Crowdfunder website (https://openstax.org/l/52Crowdfunder) connects to one of several different

22 U.S. Small Business Administration. "Funding Programs." n.d. https://www.sba.gov/funding-programs/loans
23 U.S. Small Business Administration. "Loan Fact Sheet: The SBA Loan Guarantee Program: How It Works." October 2011. https://www.sba.gov/sites/default/files/SDOLoanFactSheet_Oct_2011.pdf

business-oriented equity crowdfunding websites. It offers EGCs or small business several avenues of funding, including equity, convertible notes, and debt. The primary advantage is the ability to raise equity capital without big fees, lots of federal regulations, and red tape.

Business Domicile: State and Local Considerations

There are multiple reasons why an entrepreneur may want to consider geographic location when forming and operating a business. Of course, one practical consideration is where the entrepreneur lives, at least in terms of operating a small local or regional business. However, there are other important considerations, such as differing formation/incorporation laws, widely varying levels of regulation, different types of permitting, and other relevant factors. As a rule, a corporation is considered a citizen of both its state of incorporation and the state of its principal place of business.

The state where a person lives is not necessarily the state in which they must form and/or operate the business. For example, if a person lives in the New York City metro area, they might well have a choice of New York or New Jersey, or even Connecticut, Delaware, or Pennsylvania. The same may be true for the metro areas of other large cities. Additionally, even if a person lives in the middle of North or South Dakota, they might choose to start a business in another jurisdiction, such as Delaware, Alabama, or Wyoming, due to favorable formation regulations. The following section discusses the issue of choice of jurisdiction when forming a limited liability entity such as a corporation or an LLC.

Choice of State When Incorporating/Registering Your Business

Business entities seeking the protection of limited liability must be registered with a state. This typically includes corporations, LLCs, and LPs. Additionally, if a corporation seeks to sell stock to investors in a specific state (called an intrastate offering), it must be registered in that state. The first step is to select the type of entity to be created and then file the appropriate paperwork with the state. Each entity is typically created through the office of the secretary of state (or, in the case of Kentucky, Massachusetts, Pennsylvania, and Virginia, the secretary of the commonwealth), with each state having a different process for creating the entity. The Balance, a small business resource website, lists all state government offices in which to file the appropriate paperwork (https://www.thebalancesmb.com/secretary-of-state-websites-1201005).

Forming a business in the state where the entrepreneur is physically located is generally the easiest way to create the entity through which the entrepreneur will conduct business. Some entrepreneurs choose to create their business entity in other states for privacy reasons or for tax savings. The entrepreneur will still have to file and pay taxes in every state in which the business operates and will have to register its presence in the state in which it is physically located. Some investors might prefer out-of-state incorporation, and the entrepreneur needs to remember that the corporation will be subject to taxes, filing requirements, and other fees imposed by each state of operation and the state of incorporation.

Delaware is a particularly popular state in which to incorporate due to the ease of regulations regarding ownership structure and business-friendly laws; Nevada and Wyoming are popular as well for the same reasons. The reason these states are popular is that initial fees are cheap, there are little or no renewal fees, and the states emphasize asset protection. While Delaware, Nevada, and Wyoming offer good reasons to incorporate, they are not best choice for every business. If a business incorporates in one state but does business primarily in another, in all likelihood, it may very well have to pay the second state's fees and/or taxes in addition to those of the first state. Entrepreneurs need to consider cost and ease of operations when determining the state in which to create their business entity.

Multistate Taxation

Most businesses have a website and are glad to sell products to any buyer, regardless of where the buyer is located. Amazon is an example of a company that capitalized on the concept of Internet sales. Amazon collects sales tax from all forty-five states that have a statewide sales tax because it owes tax in every state and city in which it operates.

Multistate taxation is not something that most small businesses consider, but it is an issue that can arise in many different circumstances. For example, professional basketball players may be taxed by the state, or even the city, in which they play. This means that an NBA player could owe taxes in over 20 states if he went to every game. Just sitting on the bench in 20 different states could trigger multistate taxation, and, if the team plays in other countries, foreign taxes could also be owed. This is true for every sport and every business that operates in multiple states or other countries. It is not only multibillion-dollar corporations that are affected, but small businesses and individuals as well.

Most online multistate businesses now collect and pay sales taxes in those states with a sales tax. This was not always the case, however. For years, Amazon and other online retailers sold products without collecting any state or local sales taxes at all. The legal requirement that companies did not have to collect sales taxes in a state unless they have a "physical presence," such as warehouses, offices, and/or employees, gave online companies carte blanche to ignore state and local taxes for many years."[24] Until the 2018 US Supreme Court decision in *South Dakota v. Wayfair*, states generally did not require online sellers to collect and remit sales tax to the state. However, this case changed the rules by creating the concept of an **economic nexus**, a virtual connection with a state based on sales volume or number of transactions. This now means, in most states, that if your business meets a threshold of $100,000 in sales in that state, it may now require you to collect sales tax on online transactions. Therefore, your online business may have to collect and remit sales tax to as many as forty-five states (five states do not have a sales tax). All entrepreneurs need to develop an understanding of how the Internet and the related tax laws and regulations will affect their planned business operations. Creating a company in another state will no longer automatically avoid multistate taxes and regulations.

Technology Considerations

Most new entrepreneurs have some familiarity with technology, whether something as basic as social media or more advanced as extensive website development skills. However, most small businesses face challenges in the areas of information technology security and compliance with legal and regulatory requirements.

Not all small businesses face these challenges. They are most common in companies that handle private information, such as health records or credit card data. The storage and protection of this type of information must comply with government regulations. For example, a small government IT contractor that deals with any type of classified governmental information would need to ensure classified information was protected per regulations and not at risk of exposure. In the healthcare field, recent hacks of patient health data, some of which are handled by small businesses such as a solo practice physician's office, demonstrate the challenges

24 "Amazon's Local, State and Federal Tax Issues Explained." n.d. https://itep.org/amazons-local-state-and-federal-tax-issues-explained/

of data protection. It is a significant challenge for companies with relatively small budgets to protect data. Technology security adds large costs and requires skilled personnel, for any business, large or small. Figure 13.10 summarizes the choices of business structure discussed throughout this chapter.

Entities	Owners	Liability	Taxes	Formation	Management	Capital
C Corporation	Unlimited number of shareholders allowed	No personal liability of shareholders for liabilities of corporation	Taxed on profits, shareholders also taxed on dividend	Articles of Incorporation, Bylaws, Resolutions, Stock Certificates	Board of Directors, Officers	Shareholders purchase stock, which creates capital for the corporation
S Corporation	100 shareholders allowed	No personal liability of shareholders for liabilities of corporation	Not taxed as corporation; profits are passed through to shareholders who pay taxes	Articles of Incorporation, Bylaws, Resolutions, Stock Certificates, IRS S Corp election form	Board of Directors, Officers; if close corporation, owners can manage directly without a board	Shareholders purchase stock, which creates capital for the corporation
Sole Proprietor	One owner	Total personal liability for liabilities of business	Owner pays taxes	Usually no government filing required; DBA form needed if using an assumed name	Owner manages business	Owner puts in own capital and/or borrows from bank
General Partnership	Unlimited number of general partners	General partners have personal liability	Profits passed through to general partners who pay taxes	Usually no government filing required; General Partnership Agreement	General partners have equal management rights unless they agree otherwise	Partners contribute capital
Limited Partnership (LP)	Unlimited number of general and limited partners	General partners have personal liability; limited partners do not have personal liability	Entity not taxed; profits passed through to partners who pay taxes	Limited Partnership Certificate, Limited Partnership Operating Agreement	General partner can manage the business; limited partners do not participate in management	General and limited partners contribute capital
Limited Liability Company (LLC)	Unlimited number of members allowed	Member does not have personal liability	Taxed as a partnership	Articles of Organization or Formation, Operating Agreement	Managed by members collectively or managed by a single member	Members contribute capital

Figure 13.10 The characteristics of different business entities [C-Corporation, S-Corporation, Sole Proprietor, General Partnership, Limited Partnership (LP), and Limited Liability Company (LLC)] are provided in terms of owners, liability, taxes, formation, management, and capital. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

13.7 Mitigating and Managing Risks

Learning Objectives

By the end of this section, you will be able to:

- Explain Enterprise Risk Management and how a company uses it
- Describe litigation and financial risks
- Describe common insurance needs

Risk management is key to operating any business in a profitable fashion. There are many risks facing an entrepreneur when starting and operating a new business venture. The trick is to eliminate risks that will hurt the venture, while taking on risks that will provide for long-term profitability. The risks facing the entrepreneur need to be initially identified as part of developing a business plan and revisited regularly in ongoing operations. Preparation for adverse events affecting a new business venture is necessary, but being too pessimistic or allowing fear of adverse events to stop an entrepreneur from taking any risk will keep a business venture from achieving it greatest potential and profit.

It is important that an entrepreneur develop an understanding of the risks of the business environment. The risks include liability risks stemming from contracts and torts, sometimes referred to as operating risks, regulatory compliance risks, financial risks, and strategic risks, including taxation. Understanding how the business structure is used to operate the business venture allows the entrepreneur to develop a plan to manage business growth and understand business risk.

Enterprise Risk Management

Profitable ventures develop a strong **enterprise risk management** program, which is an integrated, cross-disciplinary approach to monitoring risk. An organization needs to look at both long-term and short-term risks at all levels of the organization, and these risks need to be evaluated from all stakeholders' perspectives and developed into an entity-wide program.

Enterprise risk management attempts to address the specific risks discussed in the preceding section by implementing a risk program that enables a business to identify and manage risk. Specifically, a business will go through a process that involves a multistage process of risk identification, risk assessment, and risk abatement. Examples of risks that businesses face include those from natural causes, economic causes, and human causes.

Natural causes of risk include disasters such as hurricanes and flooding, as well as earthquakes or other catastrophes that result in loss of life and property, as well as business interruption. For example, a business in New Orleans could be flooded by a hurricane. This results in damage to facilities and products, and threatens the lives of workers. In order to counter such causes, businesses need to plan ahead for business continuity, take out comprehensive insurance coverage, and have an evacuation/shut-down plan in place.

Economic causes of risk include global events leading to rising prices of raw materials, currency fluctuation, high interest rates, and, of course, competition from other companies in the same industry. An example of this would be unpredictable trade wars with China, leading to tariffs.

Human causes of risk refer to actions by employees, contractors, and those persons over which a company has control. These events can include torts stemming from negligence at work, labor strikes, shortages of qualified trained workers, and corporate mismanagement. An example of this type of risk would include embezzlement of money by an internal financial executive.

The use of a comprehensive approach allows a business entity to review and combine all risks into a functional perspective that allows the entrepreneur to evaluate risks and integrate new risks as different opportunities become more important to the business venture. Businesses sometimes use a risk matrix to assess or characterize the probability and impact of risk (Figure 13.11). The use of such a tool can help a business quantify risk and decide whether to undertake an activity based on its level of risk.

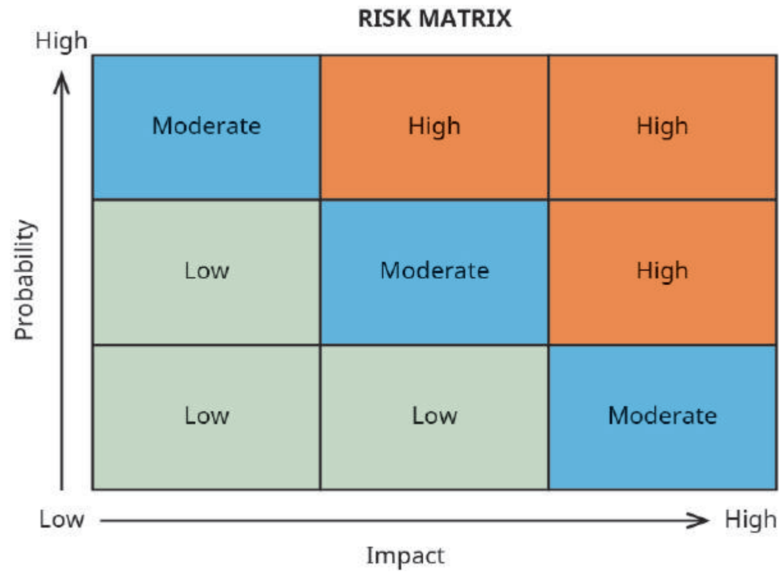


Figure 13.11 A risk matrix can be a useful tool to assess the likelihood and severity of risk that a venture may have. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Risk appetite is important for a business venture to consider, both when creating its business structure and during ongoing operations. Table 13.1 shows an overview of the considerations a business venture should entertain in both its creation and operation.

Risk Appetite[25]

Risk Item	Consideration
Existing risk profile	Current level and distribution of risks across the business and across risk categories
Risk capacity	Amount of risk the business can support while pursuing its objectives
Risk tolerance	Amount of variation the business can tolerate while pursuing its objectives
Risk attitude	Management’s attitudes toward growth, risk, and return

Table 13.1 COSO’s *Enterprise Risk Management, Understanding and Communicating Risk Appetite* outlines these considerations for assessing a business’s appetite for risk.

This is the basic approach to evaluating a new venture’s appetite for risk. Determining and understanding the risks facing a new venture should start during the preparation of the business venture’s written business plan and should continue through the operations of the venture.

25 Rittenberg, Larry and Frank Martens. “Committee of Sponsoring Organizations of the Treadway Commission (COSO)”. *Enterprise Risk Management, Understanding and Communicating Risk Appetite*. January 2012. https://www.coso.org/Documents/ERM-Understanding-and-Communicating-Risk-Appetite.pdf

LINK TO LEARNING

The Committee of Sponsoring Organizations of the Treadway Commission, also known as COSO, deals with risk management. The mission statement of the COSO (https://openstax.org/l/52COSOmission) is "to provide thought leadership through the development of comprehensive frameworks and guidance on enterprise risk management, internal control and fraud deterrence designed to improve organizational performance and governance and to reduce the extent of fraud in organizations."

Legal Risk and Protection

Business operations of any sort need to follow business regulations and laws. The failure to follow business regulations may lead to fines, lawsuits, or even criminal penalties. **Legal risk** stems primarily from a breach of contract and/or the commission of a tort. Common examples of this type of risk includes product liability lawsuits. These lawsuits are frequently very expensive class action lawsuits or regulatory investigations of dangerous products. There are many famous case examples including automobiles, asbestos, pharmaceutical drugs, breast implants, and airplanes.

Other lawsuits stem from contracts, including borrowing money from a bank. The business has an obligation to pay it back, or it breaches a covenant within a contract. Other common types of contracts are those used in selling services and products, leasing real estate, and other similar contractual obligations.

Due to liability risks, business owners and investors are always looking for ways to limit their personal liability. Incorporation is a standard risk protection strategy for this potential problem, as are the use of other types of limited liability structures such as LLCs. This is one of the main advantages of properly operated corporations and LLCs, which allow for limited personal liability of owners and investors. Partners in GPs and sole proprietors are personally liable for all of the debts of the business, even beyond their own investment in the business.

However, a particular challenge for small business entrepreneurs is that even when they form a corporation or LLC, many lenders, landlords, and other entities providing credit to a small business circumvent the limited liability protection by requiring owners and investors to personally guarantee the debts of the business operations. This means that the owner who personally guarantees the credit will have to pay back the obligation if the business cannot. An owner can obtain insurance or borrow money for such guarantees. LLCs and corporations do protect their owners, shareholders, and members from a number of different tort claims, such as personal injury lawsuits and claims made directly against the organization.

Financial Risk and Protection

An entrepreneur needs money to launch a business, whether that comes in the form of loans from family, their own savings, or investors. The founder will be expected to put their own money at risk, whether in the form of a loan to their own business or equity in their own business. If they do not have any "skin in the game," then others will not be interested in loaning them money. This means that if the business fails, it will have repercussions for the owner, even if they operate as a corporation or LLC. This is the essence of **financial**

risk: starting a new business with insufficient funds to sustain operations over an extended period of time.

Any new business owner needs to have a sound financial strategy as a part of the overall business plan. This should show income projections, the liquid assets that will be required to break even, and the expected return on investment for all investors in the first five-to-ten-year timeframe. Failure to accurately plan could mean that the entrepreneur risks business closure and bankruptcy, and investors get nothing.

Insurance Protection

Risk management and protection are enhanced with the purchase of different types of **insurance**, which involves spreading risk over a large number of people (policyholders). If a company is a corporation, it may need directors' and officers' liability insurance to indemnify the directors and officers if they get sued. Another insurance policy many companies get is called errors and omissions insurance, and this insurance coverage protects employees in negligence claims and cases if employee theft. Other types of insurance policies that most businesses carry include automobile insurance, health insurance, property insurance, and cyber/data breach insurance. Insurance coverage for a business venture needs to be specific to the business structure and its operations. Keep in mind that not all risks can be insured against—for example, a bad economy that leads to a loss of business or a bad decision by the owner to enter a market that does not work out.

Information Technology/Cybersecurity for Small Businesses

According to the SBA, the risk of hacking, ransomware, and customer privacy are equally as significant for most small businesses as for larger ones. The SBA has set guidelines related to cybersecurity for entrepreneurs. The SBA recommends the ten-step action plan shown in Table 13.2.

Small Business Administration Recommendations for Cybersecurity[26]

Step	Action
1	Protect against viruses, spyware, and other malicious code
2	Secure your networks
3	Establish security practices and policies to protect sensitive information
4	Educate employees about cyber threats and hold them accountable
5	Require employees to use strong passwords and change them often
6	Employ best practices on payment cards
7	Make backup copies of important business data and information
8	Control physical access to computers and network components

Table 13.2

26 Rebecca Martin. "Protecting Assets from Cyber Threats." *News Tribune*. November 7, 2016. https://www.newstribune.com/news/business/story/2016/nov/08/protecting-assets-cyber-threats/647637/

Small Business Administration Recommendations for Cybersecurity

Step	Action
9	Create a mobile device action plan
10	Protect all pages on your public-facing websites and apps, not just the checkout and sign-up pages

Table 13.2

The Federal Communications Commission joins the SBA in the preceding recommendations. For more information, see the following website: https://www.fcc.gov/general/cybersecurity-small-business.

WHAT CAN YOU DO?

Managing Payment Data

If you operate a small business, are you prepared to deal with hackers who break into your website and steal credit card data from consumers who bought your products online? Small businesses running an e-commerce site must comply with the Payment Card Industry Data Security Standard (https://www.pcisecuritystandards.org/). This is a regulation that could cause severe legal risk for entrepreneurs if your system is compromised, and credit card data are stolen. Consumers rightfully expect and demand a safe online experience when they visit your site. Have you paid an expert to evaluate your system and install the best security system? It may be costly, but perhaps not as expensive as the damages you could be ordered to pay by a court if credit card data are hacked.

Key Terms

B corporation business that meets a very high standard of social and environmental performance, public transparency, and accountability to balance profit with social purpose

business purpose reason the entrepreneur forms the company and determines who benefits from it, whether it is the entrepreneur, customers, or some other entity

business structure legal organization of a business; also called *entity selection*

C corporation corporation taxed the corporate level, and then again on the owners' personal income tax returns if corporate income is distributed to the shareholders as dividends

capital money raised for operating a business

corporation complex business structure created by filing the appropriate documents with the state of incorporation

economic nexus virtual connection with a state based on sales volume or number of transactions

enterprise risk management integrated cross-disciplinary approach to monitoring risk

equity crowdfunding raising of capital through the online sale of securities to the general public

financial risk starting a new business with insufficient funds to sustain operations over an extended period of time

for-profit business business structure designed to create profits that are distributed to the owners

general partnership business created when two or more individuals or entities agree to work together to operate a business for profit

insurance spreading risk over a large number of people (policyholders)

joint venture temporary partnership in which two different enterprises combine for the purpose of mutual benefits such as sharing of expenses and to work toward shared goals and the associated potential revenue

legal risk risk stemming primarily from a breach of contract, a regulatory violation, and/or the commission of a tort

limited liability company (LLC) hybrid of a corporation and a partnership that limits the owner's liability

limited liability partnership (LLP) business arrangement for professional partnerships, such as law firms or accounting firms, in which partners are licensed professionals, with limited liability for financial obligations related to contracts or torts, but full liability for their own personal malpractice

limited partnership (LP) business arrangement that has at least one general partner and one or more limited partners

not-for-profit organization (NFPO) business structure that is usually dedicated to furthering a particular social cause or for advocacy related to a common shared interest by using its surplus revenues to achieve its ultimate objective

partnership business entity formed by two or more individuals, or partners, each of whom contributes something such as capital, equipment, or skills

privately held corporation company that does not allow members of the investing public to own stock; instead, it is owned by the founder's family or friends, or a private group of investors

public corporation quasi-governmental entity, a corporation owned or sponsored by the government

publicly held corporation entity in which members of the investing public own the stock

S corporation "pass-through" entity, also known as a small corporation, where shareholders report and claim the business's profits as their own and pay personal income taxes on it

sole proprietorship business entity that is owned and managed by one individual that has very little formal structure and no mandatory filing/registration with the state

Summary

13.1 Business Structures: Overview of Legal and Tax Considerations

Being an entrepreneur carries with it the responsibility to make significant decisions, the first of which is to decide the business purpose: For example, who should benefit from the creation of the entity? The second important decision to make is whether you are going to be a for-profit or not-for-profit business. This decision is closely related to the business's purpose and is not necessarily controlled by how much revenue you think you might have but rather by who is going to "own" the entity and what it does with the profit it makes. A third decision to make is the type of business entity or structure. Choices include corporation, LLC, partnership, and sole proprietorship.

13.2 Corporations

When forming a corporation, there are numerous choices. One choice is whether to form a C- or S corporation. This is primarily a tax decision, with C corporations being taxed as corporations, and S corporations being taxed as partnerships. Which one is the best for you depends on a number of variables, including how many shareholders you aim to have and how much of the revenue you want to leave in the corporation versus take out of it in the form of dividends, considering possible double taxation issues. Another choice is whether you want to go through the process of becoming a certified B corporation through adherence to a number of social/sustainability guidelines. Finally, you must decide if you eventually want your equity (stock) to be publicly held, as it is in most large companies, or privately held, which may give you more control but limit access to capital.

13.3 Partnerships and Joint Ventures

Partnerships are a popular form of doing business. Within the structure of partnerships, there are multiple entities or structures. Making the choice can be rather complicated because an ill-informed choice could result in legal problems. Choices include a GP, LP, LLP, and LLLP, each with a different set of circumstances that might make it the right or wrong choice. The factors that would play a role in selecting which type of partnership to form include business purpose, management structure, taxation, and liability. In addition to partnerships, a related type of entity is a joint venture. Joint ventures can be combinations of two or more business entities that decide to come together for a limited period of time for a specified purpose.

13.4 Limited Liability Companies

LLCs have become, over the past twenty-five years, one of the most popular business entities for new startups. The phenomenal growth in LLCs is due to a straightforward equation: easy formation + easy operation + limited liability = popularity. LLCs offer entrepreneurs several qualities that they seem to like: They are low cost, low maintenance, protect the owner's personal assets from liability, and offer flexible taxation choices.

13.5 Sole Proprietorships

The sole proprietorship structure or entity is the most common form of doing business in the US. It is easy and inexpensive to form, is directly managed by the owner, and is subject to minimal regulation in terms of its formation and/or operation. However, with these good points are also some drawbacks. The owner has unlimited personal liability for all business-related obligations, which makes using this form of business very risky. Additionally, the only way a sole proprietor can remain that way and get access to capital is to borrow money from the bank or a perhaps a family member. Sole proprietorships cannot sell stock like a corporation can nor can they take on more partners as in a partnership or LLC.

13.6 Additional Considerations: Capital Acquisition, Business Domicile, and Technology

Multiple considerations play a role in the selection of the best business structure for each entrepreneur. This decision flows from the entrepreneur's vision of how the proposed business will operate and affects all aspects of business operations. The decision includes issues related to legal liability, taxation, and the ability to raise capital. This process may also include consideration of the best state to form and operate in, as a result of taxation, regulation, and other related matters.

13.7 Mitigating and Managing Risks

Risk is part of the equation for any startup business. There is no way to protect against every risk. However, there is a way to identify risk, plan for it, manage it, mitigate against it, and protect against it to an extent. The key to understanding and dealing with risk is not to take a utopian approach to a business startup, thinking that it will never happen to you. Risk is omnipresent. Statistically, some unexpected things will happen. Thus, the best approach to risk is to consider and implement strategies to help you and your business deal with it such as incorporation, insurance, and monitoring.

Review Questions

1. A not-for-profit business ________.

A. is allowed to retain earnings for use within the organization
B. must distribute profits to shareholders
C. must turn over to the government any excess earnings
D. can pay dividends to shareholders

2. The term "for-profit corporation" means which of the following?

A. The business must make a profit or forfeit its status.
B. The business may make or lose money without changing its status.
C. The business is not allowed to sell stock to the public.
D. The business must have more than 100 shareholders.

3. Which of the following business structures often involve two or more businesses starting a new business together?

A. sole proprietorship
B. general partnership
C. joint venture
D. corporation

4. How is an S corporation taxed?

A. at the entity level as a corporation
B. at the owner level as if it were a partnership
C. at both the entity and owner levels
D. at a special lower rate of income tax

5. A public corporation is _______.

A. owned or sponsored by the government
B. owned by member of the investing public
C. owned by a combination of public and private investors
D. none of these choices are correct

6. A C corporation is taxed _______.

A. at the entity level
B. at the individual level
C. at both the entity and individual levels potentially
D. only at the state level, not federal

7. Limited liability partnerships (LLPs) _______.

A. are normally used for firms that consist of licensed professionals such as lawyers or accountants
B. can be used for partnerships that sell services but not goods
C. are used for firms that do business across state lines
D. require that the stock be owned by fewer than 100 shareholders

8. A joint venture _______.

A. must be a corporation
B. can choose to be any type of entity
C. must be either a partnership or a C corporation
D. None of these choices are correct

9. General partners have what type of liability?

A. limited
B. joint and several
C. joint only
D. personal only

10. Of all the business entity choices, LLCs are the most like _______.

A. S corporations
B. C corporations
C. sole proprietorships
D. joint ventures

11. LLC owners are called _______.

A. members
B. shareholders
C. limited equity investors
D. directors

12. LLCs offer flexible tax treatment, meaning _______.

A. they can be taxed like corporation
B. they can be taxed like partnerships
C. they can be taxed like proprietorships
D. All choices are correct.

13. Sole proprietorships offer limited liability _______.
A. if you register it with the state
B. if you elect to be taxed as a corporation
C. if you have an SBA loan guarantee
D. Sole proprietorships never have limited liability.

14. A sole proprietorship _______.
A. pays taxes at the highest corporate rate
B. pays taxes at the lowest corporate rate
C. pays taxes at the individual rate
D. None of these choices are correct.

15. Sole proprietorships _______.
A. must register with the state
B. are similar to general partnerships in terms of liability
C. are similar to LLCs in terms of liability
D. are not allowed by law to operate outside of the US

16. States can levy a sales tax on items sold online to a customer in a different state if _______.
A. the business has a nexus with that state
B. there is an contract between the business and the state comptroller
C. the items sold are over $300
D. the business is one that only sells foreign-made items

17. As a general rule, LLCs, GPs, and SPs are taxed as _______.
A. corporations
B. not taxed
C. individuals
D. taxed twice, once as entity and once as individuals

18. Entrepreneurs can choose what state to incorporate in, and many choose _______.
A. New York
B. Delaware
C. California
D. Texas

19. Enterprise risk management includes _______.
A. identifying risk
B. risk assessment
C. risk abatement
D. All of the choices are correct.

20. A business owner can insure against all but which one of the following?
A. earthquakes
B. a bad economy
C. flooding
D. hurricanes

21. Examples of risk facing a business include ________.

A. human risks
B. economic risks
C. natural risks
D. All of the choices are correct.

Discussion Questions

1. Distinguish between for-profit and not-for-profit entities.

2. What are the distinguishing characteristics of a B corporation?

3. Why would an entrepreneur choose to operate an S corporation rather than a C corporation?

4. What are the choices of entities for operating as a group of engineers?

5. How does a joint venture differ from the other business structures?

6. Distinguish between LLC and LLPs.

7. Why are there more sole proprietorships than any other business entity in the US?

8. What are the general guidelines used to determine where your business must pay sales taxes for sales made online?

9. Identify the common types of risks that a business may face.

Case Questions

1. The Big University football team, a member of the Southeastern Conference (SEC), brings in over $100 million a year in revenue, including TV rights, ticket sales, and bowl games. Seats to a game cost well over $100, and coaches are paid millions of dollars (more than anyone else at Big U, including the president). However, despite enormous revenues, universities and their football teams are considered not-for-profit organizations and pay no taxes on the $100+ million their football programs bring in. Should a university football program be allowed to exist as a not-for-profit organization?

2. Jen started a new sustainability-oriented business six years ago, making single-serve coffee pods out of recyclable paper, rather than plastic. Her company, Jen's Pod, is now experiencing rapid growth. Jen started her company as an LLC but has been considering making a decision to incorporate. What are some of the advantages of changing to a C corporation?

3. You are headed off to college. Some close family members decide it would be a good idea to buy a house in the college town and then rent it out to students, with you also living there and actively managing it. Assuming you and your family buy it, what form of business would you select?

4. Jackson owns and runs a small computer repair business, a sole proprietorship, out of his home, with one employee. He also goes to small businesses at their locations, mostly cleaning viruses and doing other small maintenance tasks and repairs. A family physician's office calls him in for a repair. He sends his employee to do the repair. Unknown to him, his employee makes a copy of patients' personal information and sells it on the dark web. Jackson ends up being sued, and the plaintiffs ask the court to allow them to access Jackson's personal, nonbusiness bank account that also has his spouse's funds in the account. Can the plaintiffs take that money?

Suggested Resources

13.1 Business Structures: Overview of Legal and Tax Considerations

The Small Business Administration (SBA) has a great "tool box" for entrepreneurs. Tools include information on how to create a business plan and how to qualify for government contracts. It also has free online training classes and a list of networking events. Go to this link, and then click on "Create a Business Plan" and get started. SBA: https://www.sba.gov/tools

13.2 Corporations

A cost-effective solution for obtaining business counsel is the Service Corps of Retired Executives (SCORE), which provides free advice for small businesses and entrepreneurs. The SCORE organization is the nation's largest nonprofit network of volunteer, expert business mentors, with more than 10,000 volunteers in 300 chapters. You can find them at: https://www.score.org/

13.3 Partnerships and Joint Ventures

The IRS website has a clear explanation of partnerships with regard to taxation, regarding both income tax and employment/payroll taxes. You might find enough information here to help reduce the time you spend with a CPA, saving your company a lot of money: https://www.irs.gov/businesses/small-businesses-self-employed/partnerships

13.4 Limited Liability Companies

The SBA has an excellent website for LLC owners. It has information about multiple topics including comparisons with other structures, and links to other websites that offer good advice: https://www.sba.gov/business-guide/launch-your-business/choose-business-structure

13.7 Mitigating and Managing Risks

North Carolina State University, Poole College of Management, has an excellent enterprise risk management initiative. It has a wealth of helpful information for entrepreneurs on this topic: https://erm.ncsu.edu/library/article/coso-erm-framework

14

Fundamentals of Resource Planning

Figure 14.1 New Story is changing the way social enterprises manage resources through an innovative business model that uses crowdsourcing to fund construction. (credit: modification of photo provided by New Story)

Chapter Outline

14.1 Types of Resources
14.2 Using the PEST Framework to Assess Resource Needs
14.3 Managing Resources over the Venture Life Cycle

Introduction

New Story, a forward-thinking social enterprise, set out to solve a global issue that affects more than one billion people[1] worldwide: homelessness and lack of adequate shelter. The organization has impressed many investors by revolutionizing homebuilding techniques. Its founders—Brett Hagler, Alexandria Lafci, Mike Arrieta, and Matthew Marshall—share a passion for "improving lives through safe homes and a shared vision to change the traditional charity model."[2] When its founders realized the global need for proper shelter, many people having been displaced by natural disasters, they decided to take advantage of an alternate charity model by connecting with other building organizations and using crowdfunding. These four innovators combined their skills to create an organization that emphasizes building sustainable homes at a quick pace and affordable price. New Story's business model includes an innovative approach to home building and design by incorporating the needs of each family, local partners and workers, and crowdfunding campaigns to pay for construction.

At their start, New Story knew they needed the support of great mentors and an accelerator to raise funds for overhead costs, so they applied to one of the most prominent accelerators in the United States—Y

1 Joseph Chamie. "As Cities Grow, So Do the Numbers of Homeless." *Yale Global Online*. July 13, 2017. https://yaleglobal.yale.edu/content/cities-grow-so-do-numbers-homeless
2 New Story. "Founding Story." n.d. https://newstorycharity.org/about/

Combinator, a community of founders that funds startups in an accelerated three-month development process. Optimizing this opportunity, New Story built 113 houses through their “100 Homes in 100 Days” campaign in Haiti, a challenge that Y Combinator posed to them. This experience enabled the New Story team to identify global partners that extended their reach to developing communities in Bolivia, Mexico, and El Salvador.

One of the best technological advances that New Story has leveraged in its collaborations with companies is the 3-D printer by ICON, which allows a home to be printed in as little as twelve hours for only $6,000. The 3-D printer uses three main components to build a house: robotics, a special mix of materials that dry quickly, and a tablet that runs the software needed to design the home.

By securing funding and finding local community partners, New Story has built sixteen communities, with more than 2,200 homes in four countries.[3][4]

14.1 Types of Resources

Learning Objectives

By the end of this section, you will be able to:

- Distinguish between tangible and intangible resources
- Determine the venture’s tangible and intangible resource needs and how to attain them
- Describe the various funding resources available to entrepreneurs and discuss the pros and cons of each

You have learned about many opportunities for entrepreneurs to explore and the processes that ensure their success. This discussion focuses on the various resources that entrepreneurs need to start, maintain, and grow an enterprise, and, in general, how to procure those assets. Many entrepreneurs make the mistake of moving forward in their business endeavor without taking enough time to research their industry and determine what resources are required to help their business not only get off to a positive start but also the resources needed for its continued operation. Entrepreneurial Marketing and Sales covered primary and secondary sources of information and how to make use of the information gleaned from them for marketing purposes. Much of that research also applies to questions surrounding resource allocation. But before we delve into allocation, let’s examine the general categories of resources needed in just about every new venture: tangible, intangible, and financial.

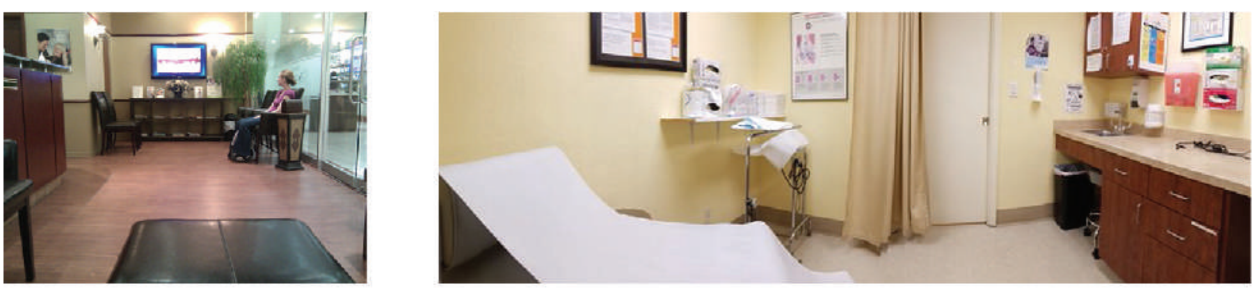
Tangible Resources

As you can imagine, resources needed for the enterprise are varied and can have different attributes. These assets are essential in the operation of the business enterprise. Assets (see Entrepreneurial Finance and Accounting) are property or resources that create a benefit to the person (or company) who owns them. They can be tangible or intangible. **Tangible resources** are assets that have a physical form. They can be seen, touched, and felt. Tangible resources differ between product-based and service-based businesses. A product-based business uses tangible resources in the production of goods sold to customers, such as raw materials, land, facilities, buildings, machinery, computers, supplies, and vehicles. The warehouse shown in (Figure 14.2) would be considered a tangible resource for a tire (product-based) company.

3 New Story. “Our Impact.” n.d. https://newstorycharity.org/impact/
4 New Story. “Founding Story.” n.d. https://newstorycharity.org/about/

Figure 14.2 Facilities, machinery, and other equipment are necessary tangible resources for a product-based company. (credit: "forklift warehouse machine worker" by "pashminu"/Pixabay, CC0)

Tangible resources for a service-based business include buildings such as a doctor's office, bank, movie theater, amusement park, retail store, or restaurant, which are enterprises that include both products and services (Figure 14.3). Facilities and resources that the business needs to provide its services and run operations may include computers, office equipment, furniture, and technological resources. As Figure 14.3 shows, the equipment and décor need to be taken into consideration because they becomes part of the product offerings, even if the core product is a service.



(a) (b)

Figure 14.3 Resources needed for a doctor's office include (a) furniture, decorations, and amenities for a waiting room and check-in areas, as well as (b) rooms with medical equipment and supplies in which to see and treat patients. (credit (a): modification of work by "icethim"/Flickr, CC BY 2.0; credit (b): modification of work by "osseous"/Flickr, CC BY 2.0)

Place of Operation

Your facility needs will depend on the type of product or service you are offering and vary in scope from office space to a food truck to a manufacturing facility to a storefront for sales. Knowing the limit of your budget (discussed in the next section) should help you focus on locations that you can afford. Experts recommend that you allocate only a certain percentage of your sales to your lease or purchase; some businesses use industry averages as guidelines. Factors to assess are location, visibility, foot traffic (how many potential customers walk by), how well the building has been maintained, the maintenance it will need in the future, how long you would want to stay in that location, and the insurance, property tax, and renovation costs, or the cost to build a new building. One approach is to make an assessment of your sales per square foot and compare those to sales of similar companies in the same industry or market. These data can be found through local commercial realtor offices, city or county government offices, and local associations.

Machinery/Equipment

Machinery and equipment are critical assets to helping launch a business. For service businesses, such as restaurants, dry cleaners, print shops, etc., the equipment can be expensive. In recent years, however, a larger reseller market has emerged for many types of equipment that are still serviceable. It is important for tax purposes to report the current asset value of used equipment and have an accountant confirm its useful life for your income statement and tax returns. (See Business Structure Options: Legal, Tax, and Risk Issues for more information.)

For companies that manufacture products, you may have to order customized tooling and assembly equipment. Again, if you must acquire new equipment, you will need to understand what its useful life is and determine whether you must procure or acquire the equipment from a supplier who charges a “piece price” on top of each component or finished product they supply to you. If you choose this second approach, your supplier may insist on a long-term manufacturing agreement to manage their risk.

Vehicles

For some businesses, vehicles are necessary equipment to run day-to-day operations. You can use your own, which can be cost effective, or you can purchase or lease one. If purchasing a used vehicle, it is best to check the Kelley Blue Book (www.kbb.com), a reference guide that lists market prices, before purchasing it from a dealership; make sure that there are no defects or negotiate a lower price if you find them; and make sure to secure documentation on warranties. Other reliable valuation sources are carfax.com, nada.com, and edumunds.com.

Many small business owners are undecided as to whether buying or leasing a business vehicle nets better benefits. Let’s assume for the purposes of this discussion that the vehicle is primarily a business vehicle and is not used a majority of the time for personal use. Relevant considerations include both tax and cost-related issues.

One difference between the purchase and lease of the vehicle relates to the tax deduction for depreciation. When you own a business vehicle, you can deduct a depreciation value over the life of the vehicle. Generally, you are not eligible to deduct depreciation on a leased vehicle. However, there is a corresponding difference with regard to the deductibility of monthly payments. With a leased vehicle, the monthly lease payments are tax deductible, whereas if the vehicle is purchased with a car loan, only the interest on the car loan is deductible as a business expense. Ultimately, the decision to lease or buy is one that an entrepreneur should make in concert with a tax advisor.

LINK TO LEARNING

There are also useful online calculators that can help small entrepreneurs explore the pros and cons of leasing versus buying a vehicle (https://openstax.org/l/52LeaseBuy) to inform these important business decisions.

Technology

No matter what business you are in, you must invest in technology to support your day-to-day operations. This typically includes computers and software, as well as Internet service and intranet/network functionality. The following list includes most of the basic investments you will need to make for your business:

- Computers: Laptops, desktops, and tablets are an obvious necessity for day-to-day tasks, communication, and even production of products or services. Think about the performance and attributes needed to operate the business for insight about what brand and quality to buy. A good operating system that can process calculations and requests faster can make your business operations smoother and more efficient.
- Internet: Every business must have strong and reliable Internet service to ensure connectivity of computers, routers, and peripherals. Communication in today’s environment cannot happen without this technology, and there are many providers that have good packages for businesses to get the bandwidth necessary to operate a business and/or to provide connectivity to customers.
- Router: If you are using multiple computers, laptops, and printers that need to be connected to each other, you will need a wireless router. A wireless router will help you keep documents and printers accessible from anywhere in your office, even if it’s a small home office. You can also have a hard-wired router, which blocks outside signal interference.
- Printer: Most businesses need a good quality printer for printing documents, marketing materials, and forms. Most printers now use color ink and come with the ability to scan and copy documents. They also vary in quality, so you will need to consider your printing needs and the costs of toner/ink to determine the level of quality you need.
- Server: If you need to store and retrieve data—such as customer profiles, emails, and sales information—you will likely need a server. The server is a hardware system with software that performs various functions that cannot be done from one computer.
- Cloud computing: Cloud services have emerged as a cost-effective way to process, store, and use data for company operations. Rather than host your data and systems on your own hardware services, many large companies like Amazon, Verizon, and Microsoft offer web services hosted on a network of computers. This option provides ongoing data integrity and security, while lowering the cost of IT services and equipment.
- Software: There are many software applications and tools that are essential for business operations. These tools support day-to-day tasks. Common software needs include accounting and billing software like QuickBooks, customer relationship management tools such as Salesforce or Marketo, word processing and spreadsheet software like Microsoft Word and Microsoft Excel, presentation software such as Microsoft PowerPoint, diagram tools like Draw.io, email marketing tools like Constant Contact or Mail Chimp, file management systems like Dropbox, online phone/meeting apps like Skype and Zoom, social

media management systems such as Hootsuite, project management tools like Bootcamp, and more. Some of these tools are free. Others carry a cost but may have free trial periods if you need to test them before investing. Most offer easy subscription payment schedules that can be set up monthly or yearly, and include ongoing software updates.

Supplies

There are many other supplies needed to operate the business, mostly basic items that you might take for granted but that need to be expensed: paper, toner, files, staplers, writing utensils, cleaners, and so on. You will likely need basic office furniture too. You may also want to invest in certain amenities that create a working environment and set the stage for your envisioned company culture—whether that's a coffeemaker, a dartboard in a break area, or whiteboards for meetings and brainstorming.

Licenses and Permits

What types of licenses might be required to operate your business? You may need a basic business license or permit provided by the government for the business to be valid, such as registering as an LLC, partnership, or company (Business Structure Options: Legal, Tax, and Risk Issues discusses these business structures in more depth). These licenses let the government know what kind of activities the business performs and ensure taxes are collected properly. They also make your business a legal entity and prove that it exists in case you need funding or permits. Some businesses require a sales tax license for products and services, whether they are tangible or digital.

Other considerations include professional certifications that pertain to the industry you are working in, such as certifications in accounting (CPA), financial advising, cosmetic services, or healthcare. Many industries require licenses before you can begin to operate; such industries include healthcare, financial services, construction, real estate, insurance, transportation, and engineering. If you will be receiving customers in your home office or storefront, you may be required to undergo a home inspection, especially from the health department if you are in a foodservice industry. Signage outside your business location may also require a permit or compliance with local regulations.

Other permits that may be required for a building include a certificate of occupancy, fire, electrical, HVAC, plumbing, and hazardous materials such as gasoline, diesel, oil, or compressed gas cylinders. Check the laws and regulations of your local and state governments to ensure your business meets the legal requirements for licensing and permits. You can do this by contacting the secretary of state in your state and also by contacting your local chamber of commerce. Importantly, these licenses and permits often carry a cost and should be part of your startup costs with renewals included in your operational budget.

ENTREPRENEUR IN ACTION

Service-Based versus Product-Based Resources

Go to bizjournals.com and select one of the small businesses profiled in the listings of current local business news. Select one service-based enterprise and one product-based enterprise. Make a list of all the different types of tangible resources they each need to start their enterprise and sustain it. How do the resource needs of each enterprise differ and how are they similar? What did you learn about resources from this activity?

Intangible Resources

Intangible resources are assets that cannot be seen, touched, or felt. Intellectual property—which includes creative imaginings such as formulas, designs, brands, and inventions—is an intangible resource, and so are the patents, trademarks, and copyrights that protect the intellectual property. For example, if you are a small business owner, you might want to protect your logo, company name, website, slogan, new product prototype, or maybe a newly developed manufacturing process that allows you to shorten production time.

In our current technological era, intellectual property has become more important than ever. The Ethical and Social Responsibilities of Entrepreneurs introduced you to intellectual property protection as an important measure to safeguarding creativity. Entrepreneurs must protect their ideas for as long as possible to sustain a competitive advantage. A competitive advantage for a business could be a formula for a product, like the recipes Kentucky Fried Chicken or Coca-Cola use for their food and beverage products. They protect their formulas so other companies do not replicate them and profit from them. Smaller companies can also invent new products, methods, and branding that will need to be protected. Patents, trademarks, and copyrights are three protections for this type of intangible resource.[5]

Patents

As Creativity, Innovation, and Invention discusses, a patent grants the owner the right to claim the ability to exclude others from making, selling, using, and importing a product or process to the United States for a period of time. This time is usually twenty years from the date the application was first submitted to the US Patent and Trademark Office (USPTO). This allows the inventor to recuperate the costs of researching and developing the novelty before competitors can copy it. Types of patents include utility, business process, design, and plant patents.

A utility patent is granted to an individual who invents or discovers something novel and purposeful such as a machine, a process, a product, an improvement to any of these, or even a composition of matter. Most patents awarded to inventors are utility or plant patents. The USPTO receives more than half a million applications each year.[6]

The application and approval process can take several years and can involve a substantial investment that can range from a couple thousand dollars to over $15,000, depending on the complexity and type of patent, as well as the fee for a patent lawyer. Lawyers can help with conducting a patent search and ensuring that the invention doesn’t yet exist, while providing guidance on the application process. Patent attorneys are often expensive, charging between $200 and $800 an hour, but they can make the process easier.

Usually, the first application an inventor files is for provisional twelve-month patent protection, which covers

5 United States Patent and Trademark Office. “What Are Patents, Trademarks, Servicemarks, and Copyrights?” *General Information Concern Patents*. October 2015. https://www.uspto.gov/patents-getting-started/general-information-concerning-patents#heading-2
6 United States Patent and Trademark Office. *Nonprovisional (Utility) Patent Application Filing Guide*. January 2014. https://www.uspto.gov/patents-getting-started/patent-basics/types-patent-applications/nonprovisional-utility-patent#heading-6

the invention for the first year while the inventor waits for the approval of a final, nonprovisional patent. A patent examiner processes the application and determines whether to award the protection or not. Having the help of a patent lawyer is not necessary, but it usually makes the process easier and increases the odds of receiving the patent. Not having a lawyer can delay the process or prevent the inventor from getting the patent, especially if the inventor is not familiar with the process, or if the invention is complex. Choosing a lawyer carefully is important, as experience and knowledge of the process matters. If the patent is awarded, the final patent goes into effect retroactively to the filing date of the provisional patent, and the inventor has twenty years of protection against other companies copying the design. Figure 14.4 shows an example of a patent for the well-known 3-D printer, which was awarded in 1986 to its inventor Chuck Hull.[7]

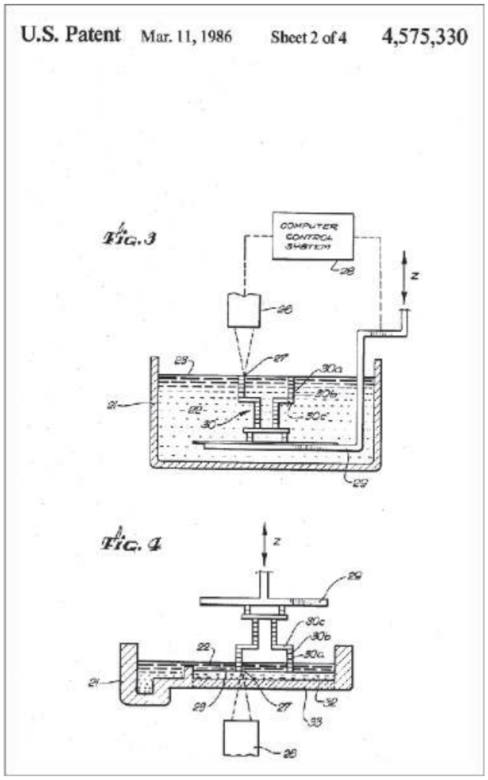


Figure 14.4 Here is an example of a schematic from Chuck Hull's 3-D printer patent provided by the US Patent and Trademark Office. (credit: modification of "US Patent US4575330A" by Charles W. Hull/Google Patents, Public Domain)

A business process patent is a type of utility patent granted to someone who develops a new business method, and just like a tangible product, the method must be new and nonobvious, and it must employ an equipment or type of technology to be valid. Nonobviousness is a legal requirement for a patent acquired under federal law (35 U.S.C. § 103), and generally means something that is not readily apparent. A proposed invention is obvious if someone of ordinary skill in a relevant field could easily make the invention based on prior art and thus would not be patentable, whereas a nonobvious invention is capable of being patented. The application must include a description of how the method works with the technology or equipment, and it must have a real-world application and not just be an idea. An example is Amazon's 1-Click shopping cart that enables people to store credit card and shipping information to enable speedy purchases.

7 Joseph Flynt. "A Detailed History of 3D Printing." *3D Insider*. n.d. https://3dinsider.com/3d-printing-history/

A design patent is granted to an individual who creates something original and novel as an ornamental design. A design patent involves the actual design of an invention. For example, Apple has hundreds of design patents for its iPhone, and Samsung has hundreds of patents for its various products. (Figure 14.5) shows a patent granted to Apple in 2011. Read the “Abstract” portion. Does it describe something familiar? Every design element, like the LCD screen, the width and length of the phone, and many of its other features that are added to each of its generations, requires a new patent.

US007864163B2

(12) **United States Patent**
Ording et al.

(10) **Patent No.:** **US 7,864,163 B2**
(45) **Date of Patent:** **Jan. 4, 2011**

(54) **PORTABLE ELECTRONIC DEVICE, METHOD, AND GRAPHICAL USER INTERFACE FOR DISPLAYING STRUCTURED ELECTRONIC DOCUMENTS**

(75) Inventors: **Bas Ording**, San Francisco, CA (US); **Scott Forstall**, Mountain View, CA (US); **Greg Christie**, San Jose, CA (US); **Stephen O. Lemay**, San Francisco, CA (US); **Imran Chaudhri**, San Francisco, CA (US); **Richard Williamson**, Los Gatos, CA (US); **Chris Blumenberg**, San Francisco, CA (US); **Marcel Van Os**, San Francisco, CA (US)

(73) Assignee: **Apple Inc.**, Cupertino, CA (US)

(*) Notice: Subject to any disclaimer, the term of this patent is extended or adjusted under 35 U.S.C. 154(b) by 688 days.

(21) Appl. No.: **11/850,013**

(22) Filed: **Sep. 4, 2007**

(65) **Prior Publication Data**

US 2008/0094368 A1 Apr. 24, 2008

Related U.S. Application Data

(60) Provisional application No. 60/937,993, filed on Jun. 29, 2007, provisional application No. 60/946,715, filed on Jun. 27, 2007, provisional application No. 60/879,469, filed on Jan. 8, 2007, provisional application No. 60/879,253, filed on Jan. 7, 2007, provisional application No. 60/824,769, filed on Sep. 6, 2006.

(51) **Int. Cl.**
G06F 3/041 (2006.01)

(52) **U.S. Cl.** **345/173**; 715/234; 715/781

(58) **Field of Classification Search** 345/173–178; 178/18.01–18.09, 18.11; 715/810, 828–831, 715/234, 781, 700
See application file for complete search history.

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(Continued)

Primary Examiner—Stephen G Sherman
(74) *Attorney, Agent, or Firm*—Morgan, Lewis & Bockius LLP

(57) **ABSTRACT**

A computer-implemented method, for use in conjunction with a portable electronic device with a touch screen display, comprises displaying at least a portion of a structured electronic document on the touch screen display, wherein the structured electronic document comprises a plurality of boxes of content, and detecting a first gesture at a location on the displayed portion of the structured electronic document. A first box in the plurality of boxes at the location of the first gesture is determined. The first box on the touch screen display is enlarged and substantially centered.

61 Claims, 29 Drawing Sheets

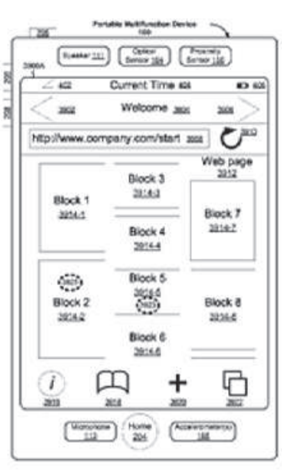

Figure 14.5 Here is an example of a US patent awarded to Apple. (credit: modification of "Sample patent to illustrate 'INID' numbers" by USPTO/Wikimedia Commons, Public Domain)

A plant patent is as it sounds—it's granted to someone who creates or discovers a new type of plant, as in the living organism, not facility. The patent applies to a plant or its contents, which must be innovative and nonobvious, and must have utility.

LINK TO LEARNING

Nolo is a legal resource for small businesses and consumers (https://openstax.org/l/52Nolo) that provides information on the basic requirements for utility, design, and plant patents.

Trademarks

A **trademark** provides the owner the ability to use a name, symbol, jingle, or character in conjunction with a specific good. A **service mark** is, according to the USPTO, a word, phrase, symbol, or graphic that identifies the origin or source of a service.[8] Both marks prevent others from using those same assets to sell their products. A trademark can be the most valuable asset a company owns. Customers will often pay more for a product or service if it comes from a specific brand with a good reputation. Customers view brands as a promise of the experience they will have: Brands promote confidence in the product and the benefits that the consumer may enjoy. Successful businesses create brand loyalty through these efforts, creating a relationship with customers. When users see themselves in the brand, they will choose that brand to create their own identities.

Protecting the name of the company and its products, jingles, logos, and even social media is therefore necessary to gain and protect a competitive advantage, because among competitors, the trademark is often the only way to distinguish among products. Can you think of a brand you are loyal to—perhaps your Apple iPhone, your Starbucks coffee, or your local entertainment spot? Consider what that company has done to earn your loyalty.

Usually, once the business begins to use its name, logo, character, and other assets, they are informally protected by trademark law and can use the ™ symbol. However, if a business wants extended protection, they should file for legal trademark protection.

Trademarks can be registered at the state or federal level. As the names imply, state trademark registration protects the business's mark within its own state, and federal trademark registration protects the business's mark across the United States. Once the registration has been filed and accepted at the federal level, the business can use the ® symbol after the protected item. Examples of trademarks include the Apple name and logo, the McDonald's logo, the talking GEICO lizard, and Nike's "Just Do It" slogan.

If you are opening your own candle and soap company, for example, you might want to register your company name and logo initially to prevent others from using it and benefiting from your reputation. If you decide to create a jingle, a slogan, a character, or another branding asset, you can do it while you develop and grow your business, as it can become cumbersome and expensive if it's done all at once. Getting a trademark itself is not

8 "Trademark Basics." United States Patent and Trademark Office. n.d. https://www.uspto.gov/trademarks-getting-started/trademark-basics

as difficult as getting a patent, but just as with a patent, getting a lawyer's help can prove beneficial. Trademarks are not as costly—it may cost a few hundred dollars to file the application—but attorney fees can vary, depending on the type of project and the length of time it takes to process the application. This can range from a few hundred to thousands of dollars. This type of intellectual property can provide an opportunity for your company to be sustainable for years to come and avoid other businesses copying or using your ideas to promote themselves.

LINK TO LEARNING

Check out this video on the basics of applying for a trademark on the USPTO website (https://openstax.org/l/52tradeUSPTO) to learn more.

Copyrights

A **copyright** is provided to an author of an original work, including artistic, dramatic, architectural, musical, literary, and software works. Copyrights are granted by the Copyright Office, which is a part of the Library of Congress.[9] Table 14.1 summarizes the types of US intellectual property protection.

Types of Intellectual Property Protection

Intellectual Property Protection	Protected Items	Office Providing Protection
Patent	Machine, process, improvement, plant, design, and matter composition	US Patent and Trademark Office
Trademark	Name, symbol, jingle, character, and logo	US Patent and Trademark Office
Copyright	Artistic, dramatic, architectural, musical, literary, and software	US Copyright Office

Table 14.1

The US Copyright Office's website offers a variety of publications that further explain what works are or are not eligible for copyright: https://www.copyright.gov/help/faq/faq-protect.html. While filing with the Copyright Office is not required for copyright (the rights exist when the work is created), the process provides more formal legal documentation to protect your business interests. Registration requires a fee (basic registrations are under $100), and other services or specialty requests may add additional expenses.[10]

Trade secrets are oddly similar yet completely different from traditional intellectual property (patents, copyrights, and trademarks.) Trade secrets derive their legal protection from their inherently secret nature, not from a grant of exclusivity by the government. In fact, patents and copyrights are required to be made

9 "What Does Copyright Protect?" Copyright.gov. n.d. https://www.copyright.gov/help/faq/faq-protect.html
10 "What Does Copyright Protect?" Copyright.gov. n.d. https://www.copyright.gov/help/faq/faq-protect.html

public, whereas trade secrets are not.

Examples of trade secrets range from the formula for Coca-Cola to the Google search algorithm. An inventor has a choice: patent the invention or keep it as a trade secret. Some advantages of trade secrets include the fact that a trade secret is not limited in duration/time (patents generally only last for twenty years). A trade secret may therefore continue indefinitely as long as the secret is not revealed to the public. However, a trade secret is more difficult to enforce than a patent because the level of protection granted to trade secrets is generally considered weaker when compared with the protection granted by a patent. Additionally, a trade secret may be patented by someone else who developed the relevant information by legitimate means.

Determining Your Resource Needs and How to Attain Them

As you begin your entrepreneurial plan, start by developing a list of the basic tangible and intangible resources you will need and determine their availability. For example, let's say you are starting a solar panel manufacturing company called Helios Panels. Your new manufacturing plant will require you to have a 10,000 square foot factory, where you will need two or three specialized machines to build your solar panels. Unfortunately, the area of town that you like does not have buildings available. You will probably need to look for another location where there's a facility that fits your needs that is easily accessible for transport vehicles. If you don't make your list first, then you run the risk of ending up in a facility that is not suitable. Table 14.2 and Table 14.3 provide starting points for thinking through the tangible and intangible resources needs for your venture.

Tangible Resource Needs

Resource	Considerations	My Needs
Location/ facility	• Will there be customer interaction, and if so, does the location meet the needs of the target market? • How much square space is needed? • How well will the location meet the needs of employees? • Does inventory need to be stored?	
Machinery/ equipment	• What equipment is needed to create the product or provide the service? • What quantity of equipment is needed to meet customer demand? • Are there any special requirements for machinery, such as level ground, vibration or sound protection, or water and electricity supplies?	
Technology	• What hardware is needed (computers, tablets, printers, or routers)? • What software is required? • What type of Internet service is needed? • What other technology architecture might be required (server, network, or cloud computing)?	

Table 14.2 This table can help you determine your tangible resource needs.

Tangible Resource Needs

Resource	Considerations	My Needs
Vehicles	• Are vehicles needed, and if so, for what function (transporting goods or meeting clients)?	
Miscellaneous supplies	• What basic supplies may be needed (desks, chairs, wastebaskets, or whiteboards)? • What office supplies are needed for operations?	
Licenses/ permits	• Is the business licensed as a legal business entity if needed? • Does the location/facility require any licenses or permits to operate? • Do all parties involved in providing products/services have necessary licenses or certification to be in compliance with industry and government standards?	

Table 14.2 This table can help you determine your tangible resource needs.

Intangible Resource Needs

Resource	Considerations	My Needs
Patents	• Does the venture merit patent applications (utility, design, or plant)?	
Trademarks	• Do the immediate plans or long-term vision include elements that should be trademarked (name, symbol, logo, jingle, or character)?	
Copyrights	• Do the company's offerings include intellectual property such as artistic, literary, architectural, or software works that need to be protected?	

Table 14.3 This table can help you determine your intangible resource needs.

Business owners are constantly faced with difficult decisions about resources. A **decision tree** is a beneficial tool that *Business News Daily* describes as a "flowchart graph or diagram that helps explore all of the decision alternatives and their possible outcomes."[11] In other words, it uses a logical framework to help us make decisions. First, you determine what your different options are for use of resources, and then you can calculate the return for each option, using mathematical models that help estimate the probability of successful outcomes.

For example, let's say that you must decide which piece of expensive equipment to use in the manufacture of your solar panels. You can create a decision tree to determine the best course of action (Figure 14.6).

11 Chad Brooks. "What Is a Decision Tree?" *Business News Daily*. March 28, 2014. https://www.businessnewsdaily.com/6147-decision-tree.html

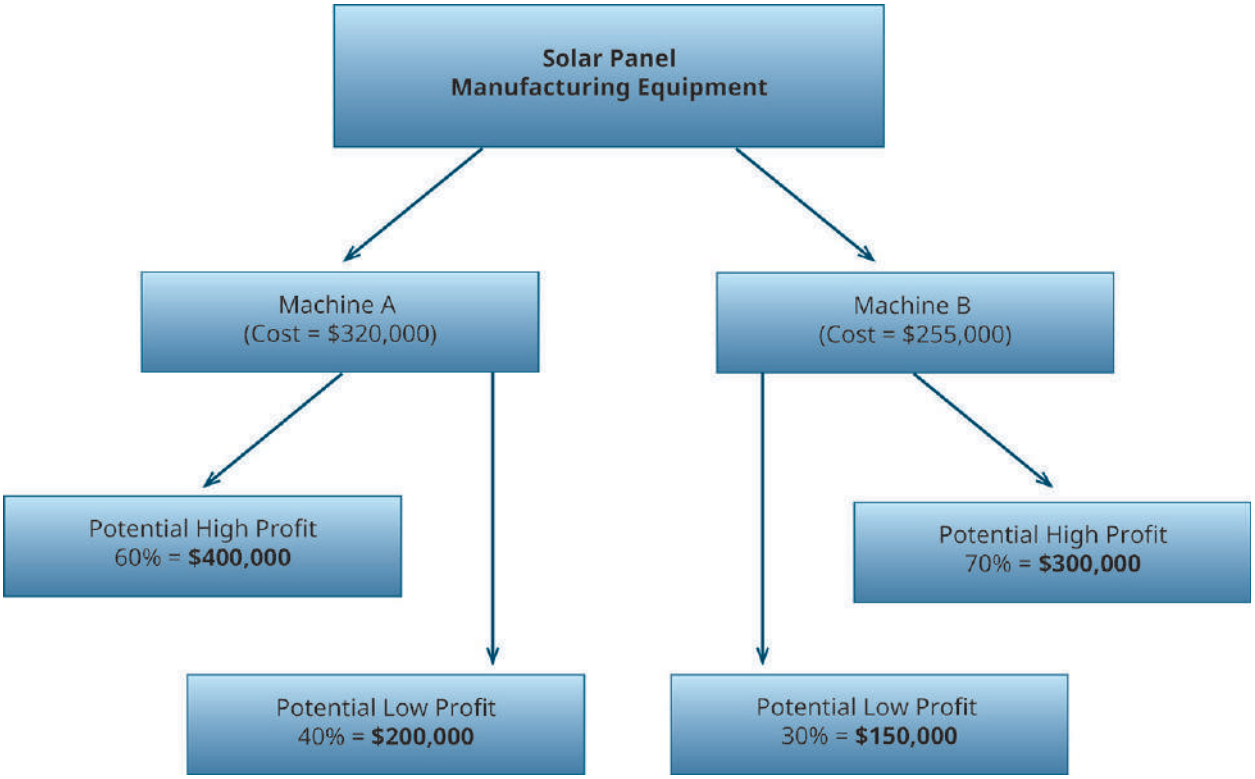

Figure 14.6 A decision tree can help estimate the probability of success when making a decision regarding how to allocate resources, sometimes including examining cost tradeoffs. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Working through these questions can help you be prepared prior to opening the business and identify additional resources you will need in the future. This takes time and effort, but the payoff is worthwhile in having a clear understanding of needs to support a path to success. Furthermore, the risk of expensive and unrecoverable mistakes can be mitigated when one uses management tools such as the decision tree tool. Creating a checklist with answers and details (Figure 14.7) can help sort through and organize your thoughts and your action steps.

Figure 14.7 Sample checklist for determining whether a location and other physical resources are appropriate for Helios. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

ARE YOU READY?

Get Organized

- Create a checklist of the various resources you might need for your own business idea. Categorize them into tangible and intangible.
- Prioritize them in order of importance to your growing enterprise and what cost factors to consider for each.
- Construct a decision tree that shows what choices you had to make as you made your checklist.

Often in the planning stages, entrepreneurs fail to identify all the resources they may need in the startup phase, and, as a result, the business suffers and opportunities are lost. This article from Business News Daily on decision trees (https://openstax.org/l/52BusNewDecTree) can be a helpful resource when completing this exercise.

Funding Resources

Funding resources are the monetary resources necessary to start and operate a business and are usually the biggest challenge that entrepreneurs face. If you don't have funding, you are not able to secure your basic resources—that is, to buy the raw materials to make a product, hire employees, purchase inventory, or secure facility space, furniture, or equipment. Entrepreneurial Finance and Accounting covers these funding sources in depth. Here, we consider how these can be best leveraged to acquire the other resources needed for your business.

Personal Savings

Most entrepreneurs start their business by tapping into their personal savings. Many entrepreneurs will work another job while setting aside some savings money for their venture. Using personal savings can be a good idea if the business requires low startup costs (marketing material, software, equipment, products, and materials) and low maintenance costs for the first year. This can include businesses that don't require as much capital, such as professional services (engineers, accountants, and business consultants). Saving for major expenses like equipment can also help avoid paying fees and loans, but it may tie up the money in assets and will prevent you from covering payroll or other operational costs. Having cash reserves on hand can ensure that your basic business needs are met. The positive aspect of using your own savings is that you have the opportunity to use the funds as you see fit: You decide how you want to spend the money. A potential negative with this freedom is that if the business fails, your investment will be depleted as well.

Bootstrapping

Bootstrapping literally means to pull yourself up by the bootstraps with tenacity and "sweat equity" using the bare minimum resources.[12] This means that you do things as cheaply as possible until you start earning revenue that you can reinvest in the business. For example, entrepreneurs starting out might work from home to save on rent and utilities, might create a website and marketing materials themselves, and might use social media to promote the business. Once a customer base is established, the entrepreneur may explore options for outside-of-the-home office space and invest in professional services from a website designer and marketing printer.

Using credit cards can be an option to help the entrepreneur bootstrap and not take out loans. This can be risky, but if you are disciplined and only use them for the essentials of the business, such as production or marketing, they can really help get the enterprise off the ground. Paying off the balance every month and using credit cards that provide rewards and cash back can help develop healthy habits, while reaping the rewards to use on items that are highly needed.

An example of the savvy use of a credit card comes from Johnny Cupcakes, a "t-shirt bakery" in Boston, created by Johnny Earle, who started selling witty cupcake t-shirts, as shown in Figure 14.8, out of the back of his '89 Toyota Camry. He used his parent's credit card to charge the materials for his t-shirts and bootstrapped his operations out of his home with family help until his clever shirts started selling so well that he had to open his first retail store. Fortunately, Earl was smart enough to use the credit card only for production of his t-shirts, and once they sold, he used the revenue to pay off the credit card completely so as to not incur any more debt or interest charges. Eventually, his business started to flourish and he didn't need to use credit cards to operate. Today Johnny Cupcakes brings in millions of dollars. The company has expanded to locations in Los Angeles and London, and Earle speaks to entrepreneurs all over the world.[13]

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12 Alejandro Cremades and Barbara Corcoran. *The Art of Startup Fundraising: Pitching Investors, Negotiating the Deal, and Everything Else Entrepreneurs Need to Know* (Hoboken, New Jersey: Wiley, 2016).

13 Johnny Cupcakes. n.d. https://johnnycupcakes.com/pages/about

Figure 14.8 Johnny Earle started his company, Johnny Cupcakes, using his mother's credit card to fund the production of the shirts. His car was his first storefront. (credit: photo provided by Johnny Cupcakes, work by Dave Green, @JOHNNYCUPCAKES, https://johnnycupcakes.com/)

Bank Loans

Bank loans are another funding option with different banks that focus on various industries and different interest rates available. Usually, these loans can be secured by some sort of equity. This can take the form of personal assets, such as the owner's home, cash, vehicles, other commercial property, or business assets like equipment, inventory, or cash. Rates can be high, especially for startups that don't have any credit history. The paperwork required can also be cumbersome, and the payments have to be made on time regardless of how much revenue the business is earning. Organizations such as the Small Business Association (SBA) and local chambers of commerce can be helpful in providing guidance and loans (see Entrepreneurial Finance and Accounting).

Bank loans are most helpful when the business does not have enough money to fund a particular part of operations, such as expanding production by means of buying new equipment. Although loans may be difficult to attain, there are local banks and large banks that provide help to small businesses and startups. Interest rates may range from 5 to 8 percent, and the loans can be used for the purchase of capital equipment or assets that are necessary for the business to take off, such as land/facilities, working capital, or marketing. Once a business has established making payments on the loan, it also establishes good credit. It may then qualify for larger loans or a **line of credit**, which is an amount of money that a bank allows a business to borrow on demand to expand a business or to have cash flow for required expenses. Usually, there is an interest rate attached to the line of credit that will have to be paid back within agreed terms, and often an annual fee for an open line of credit. Entrepreneurs with good credit ratings can access amounts around \$25,000–50,000 without taking a term loan.

Friends and Family Members

Friends and family can be a great way to get quick funding because they usually believe in your skills and ideas, and they want to see you succeed. Entrepreneurs should have a specific strategy for asking friends and family for the amount they need to open a business. This can range from a few hundred to thousands of dollars. You will want to determine whether to ask many people to help you with small investments or have one or a few people provide larger amounts. It depends on the strength of your relationships and how much stress you’re willing to introduce into the relationship. Many entrepreneurs have persuaded friends and family members to give small amounts, and some have persuaded a few to give large amounts of money. Regardless, it is important to have a strategy for asking and a plan for how to pay them back. You will also need to be prepared to discuss their expectations regarding the use of their money. Are they expecting to be part owners of your company? Is this a loan that must be repaid? Is it a gift? It is always best to keep communications about funding the business professional. If they are investors, the expectation is that they will have a say in how you run your business.

Once you have figured out what interest you are willing to give up in return for the investment, make it professional by giving a presentation about the business and signing a contract to ensure that they will get paid back, whether in money or shares of stock. This safeguards the relationship by holding you accountable for paying back the money.

There are many contract templates available online, such as those at Loanback.com, Lendingkarma.com, Exilend.com, and Zimplemoney.com. These contracts should include the amount of money you’re asking for, the interest rate, timeframe of payback, installment information, and any other necessary terms. If the money is a gift, it is recommended to get a statement in writing that those funds are a gift in case you need proof of where that money came from and whether payback was expected.

Angel Investors

Angel investors are usually professionals who have accumulated wealth and are open to sharing their wealth in exchange for some sort of equity. Many are former entrepreneurs who have harvested their business and enjoy providing guidance and support to new entrepreneurs. Others have worked in large corporations and have an abundance of knowledge and interest in new technologies. The name given to this type of investor began with those “angels” who helped fund Broadway shows in the last century.[14] The name stuck, and now they fund many industries, not just the arts. Many of these angels belong to groups of investors such as private equity groups, while others look for opportunities on their own. They also can range in their lending capabilities, as they are private individuals with differing amounts of wealth.

An example of an angel investor is Natalia Oberti Noguera (Figure 14.9), the CEO and founder of an organization called Pipeline Angels that helps provide capital for women and nonbinary entrepreneurs. She is not the typical angel investor, as she focuses on empowering minorities through her business coaching and providing capital opportunities for women.[15]

14 Alejandro Cremades and Barbara Corcoran. *The Art of Startup Fundraising: Pitching Investors, Negotiating the Deal, and Everything Else Entrepreneurs Need to Know* (Hoboken, New Jersey: Wiley, 2016).
15 Natalia Oberti Noguera. n.d. www.nataliaobertinoguera.com

Figure 14.9 Natalia Oberti Noguera is founder and CEO of Pipeline Angels. Her goal is to change the face of investors and support women and nonbinary social entrepreneurs. (credit: modification of "TechCrunch Disrupt NY 2017 - Day 2" by TechCrunch/Flickr, CC BY 2.0)

Venture Capitalists

Venture capitalists are usually large private or public firms that are interested in pooling funds to invest in high return, high-risk startups or growing firms. These investors want high payouts in an average span of three to five years, so they will likely fund promising businesses in technology sectors, pharmaceuticals, media and entertainment, and biotechnology.[16] The business must give up some of its equity to gain those funds. Usually, venture capitalists not only provide the funds necessary to start or grow the business, but will also provide guidance and expertise. More than likely if you are seeking funds this way, you will probably deal with an established venture capital firm, but occasionally, an individual may work alone as a venture capitalist.

For example, Birchbox received $90 million from their first rounds of funding from venture capitalists. This allowed them to fully develop their business model and grow to be valued at over $500 million. Most of the funds went to creating the technology that fueled their website, hiring customer representatives, and creating distribution systems.

Crowdfunding

Just like in the case of New Story (Introduction), there are instances where businesses rely on crowdfunding, which is a good vehicle for collecting large amounts of money made up of small donations. That's the beauty of crowdfunding: You can receive various amounts of money from many people through an online platform, with a request that can be shared not only with family and friends, but with many other people who are passionate about your idea. New Story created a new business model that allows them to crowdfund its home building projects entirely. This model, together with New Story's partnerships, has helped them create many communities in different countries, thanks to the donations from people who care about this cause. There are many types of online platforms that focus on specific industries. The most common platforms include Kickstarter.com, Indiegogo.com, CircleUp.com, and Fundable.com, among others. In 2012, Congress passed the JOBS Act to allow startups to raise money from people who were not professional investors. Crowdfunding was born from the ability to raise money without having to create an IPO.

16 Rachel Hallett. "These Are the Industries Attracting the Most Venture Capital." *World Economic Forum*. February 13, 2017. https://www.weforum.org/agenda/2017/02/these-are-the-industries-attracting-the-most-venture-capital/

LINK TO LEARNING

Visit the Financial Industry Regulatory Authority site explaining the details of crowdfunding and the JOBS Act (https://openstax.org/l/52FINRA) to learn more. Notice the rules for specific amounts raised.

Grants

A tougher way to get funding for your venture is by applying for grants from the government at the federal, state, and local levels.[17] Most require a match of funds by the entrepreneur and may have many more requirements, but they can be a good way to launch. You can start by looking up federal grants and work your way down to your local city level. Federal grants are broken down by industry. Usually, they focus on fields that have innovations in technology, science, or health. Some of those grants such as the Small Business Innovation Research Program or the Small Business Technology Transfer Program focus on these disciplines and can range from $150,000 to $1 million. Other governmental entities offer grants, such as the National Aeronautics and Space Administration, the National Science Foundation, and the Departments of Energy, Health, Defense, and Education; these grants focus on their fields, and their amounts and requirements vary.

State grants, on the other hand, generally focus on economic, educational, or social issues. These can be smaller and easier to acquire since competition can be lower. Each state has its grants posted on the https://www.grants.gov/ website and includes requirements and funding opportunities. These focus on areas of growth and needs such as green technology, education, environmental initiatives, tax incentives, job retention, historic preservation, and tourism, among others.[18] Grants are also discussed in The Ethical and Social Responsibilities of Entrepreneurs.

Resource Funding Considerations

When evaluating resource needs, you can consider these questions:

- How will I obtain the money needed to operate the business on a daily basis?
- When might I need to hire staff, and how much would their wages and benefits cost?
- Where are these sources of money I can tap into for both immediate and long-term needs?
- Would a line of credit be a better option for my business or should I pursue a term loan?
- Is borrowing from friends and family a practical option?
- Are there angel investors who fund businesses in my industry who I can investigate?
- What will I need in terms of assets and financial reserves to open my business and keep the doors open for at least six months? One year? Five years?

Based on your needs, you will be able to choose from the type of funding that best suits you. Table 14.4 expands on the pros and cons of these different funding resources.

17 Priyanka Prakash. "Small Business Grants: 107 Ways to Get Money for Your Business." *Fundera*. October 15, 2019. https://www.fundera.com/blog/small-business-grants
18 Priyanka Prakash. "Small Business Grants: 107 Ways to Get Money for Your Business." *Fundera*. October 15, 2019. https://www.fundera.com/blog/small-business-grants

Pros and Cons of Funding Types

Types of funding	Pros	Cons
Personal savings	• Only risk your own funds • Use the funds as you see fit • Can take the time to save up funds • Can run a smarter business by making better decisions on a tight budget	• Risk losing all your savings/retirement accounts • Hard to save enough money to fund a business, so the amount is limited • Can cause cash flow challenges
Bootstrapping	• Requires the least amount of investment • Using credit cards can potentially provide rewards	• May not get paid until the business makes money • Requires “sweat equity” using minimal resources • May need risky use of credit cards
Bank loans	• Ability to get greater amounts of funding than personal savings and bootstrapping • May be faster funding than waiting to save up • Builds credit history • Set payment rate • No loss of equity in venture	• Must qualify for loan on the business creditworthiness • Must qualify for loan based on personal creditworthiness of all spouses, partners, members, or stockholders • Must pay interest • May default loan • Cash outflow on interest and principal payments • Can jeopardize needed cash for other productive uses • Potential loss of collateral • Potential decrease in credit rating
Venture capitalists	• Potentially large sum of money • Ability to grow quickly • Not a loan, so no regular cash repayment plan • Access to useful connections and experience in the industry	• Give up ownership/equity • Have to take others’ direction • Expectation of payoff • May cause company to grow too quickly • May relinquish management control or decision-making to an unknown person • Can be squeezed out of own company

Table 14.4

Pros and Cons of Funding Types

Types of funding	Pros	Cons
Angel investors	• Useful investing networks and experience in the industry • Ability to guide you toward success • Invest funds in exchange for equity and participation in the venture's success • Not a loan	• Give up ownership • Have to take others' direction • Expectation of payoff • May relinquish management control or decision-making to an unknown person • Can be squeezed out of own company
Friends and family	• Can be easier and faster to acquire • People believe in your idea/ skills • Ability to raise from many or a few • No credit check • Flexibility for payback	• Expectations need to be met • Risk losing their money • Usually will raise less funding • May complicate relationship • Might be embarrassing • Has tax implications if provided as a gift
Crowdfunding	• Ability to raise cash from many people • Fast • Larger overall sums	• Requires significant planning/work • Requires some sort of reward • Can be stressful method • Transparency required and may need to be documented
Grants	• Range from small to large • May have little competition • May offer training • Free application	• May only focus on certain industries • Difficult to obtain • Long process • Reporting may be required • Repayment may be required if specific conditions are not met • Some conditions of the grant are outside the control of the benefactor

Table 14.4

WORK IT OUT

Informational Interviews

Do some research within your industry to see how your idea compares to those who have been in business five years or more (reaching success) and those in business five years or less (startups). Explore whether you can access needed resources to successfully launch the intended enterprise and reach the proposed customer.

If you can, interview others in the industry to get a pulse on the considerations of entry into this business. For example, you can ask them the following questions:

- What experience did you have in your industry before you started your own business?
- What made you consider opening a business?
- What were some of the positive aspects you saw about this industry? What were some negative aspects?
- What are the obstacles of entry into this industry?
- How much funding did you need to get started? How much to continue operating?
- What networks of business owners, mentors, and guides did you tap into before you started your business?
- What organizations did you join to get help with your business?
- How much time did you spend in your business each week?
- What did you give up in your personal life when you started your business?
- If you could start over, what would you do differently? Would you still open your own business?
- What advice do you have for someone who is just starting?

14.2 Using the PEST Framework to Assess Resource Needs

Learning Objectives

By the end of this section, you will be able to:

- Describe the components of the PEST framework (political, economic, sociocultural, and technological factors)
- Apply the PEST framework to assessing resource needs
- Understand how to assess typical resource costs at startup

As you venture into planning the resource allocation for your enterprise, you will learn that there are a variety of tools that can help you. It is important prior to launch to identify the minimum resources needed for startup. Some businesses will require more capital equipment (such as production machines); some require more technological resources, such as software (or software designers); some companies may require a lot of funding at the beginning of their quest, whereas some will require only a small investment of money. The level of resources needed for an enterprise changes over time, as well.

As the entrepreneur goes through the brainstorming process to identify the feasibility of the idea, they can simultaneously begin to think practically about what they will need to make this business operational: What raw materials are needed to manufacture the product? How many employees are needed at each phase? Will a physical site be necessary, and, if so, where will it reside?

Narrowing down the minimum resource needs of the enterprise in response to some or all of these questions is essential to a successful business launch. The entrepreneur can gather information and make an informed decision on what needs have to be covered at the beginning of the venture. This information can be condensed into the business plan, marketing plan, or pitch that can be shared with stakeholders. The information gleaned from the stakeholders' responses to the plans informs not only the entrepreneur and stakeholders internal to the business, but external stakeholders such as banks, investors, suppliers, vendors, and partners. The information is essential for the decision-making process. One tool that can help ensure that planning is comprehensive and well thought through is the PEST framework.

PEST Framework

The **PEST framework** is a strategic assessment tool that entrepreneurs can use to identify factors that may influence access to essential resources. PEST is an acronym for political, economic, sociocultural, and technological factors (Figure 14.10).

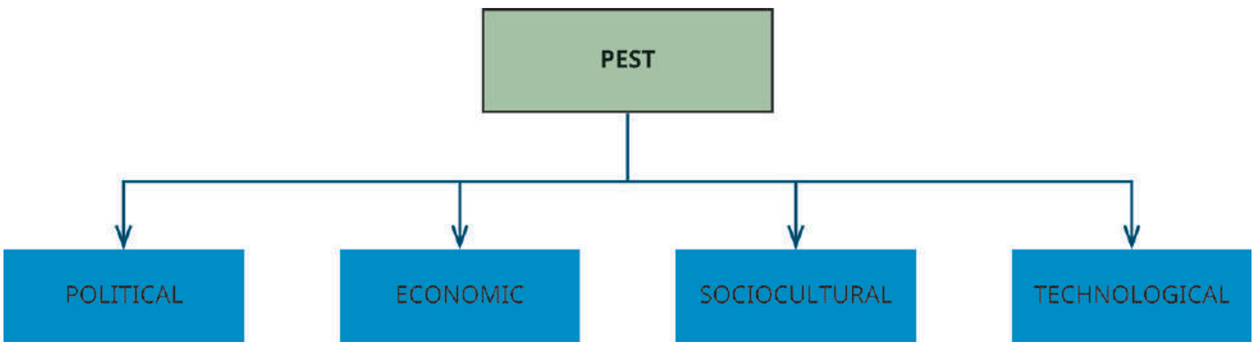


Figure 14.10 Gaining an understanding of these four factors can help entrepreneurs gauge access to important resources. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

LINK TO LEARNING

Watch the video about PEST (https://openstax.org/l/52PEST) to learn more. Why is it important to look at the outside environment? How does the PEST analysis work?

Political Factors

Although you may hope to be your own boss, make your own schedule, and follow your own rules, you must still work within the realities of outside factors that affect your business. **Political factors** stem from changes in politics, such as the policies of a new presidential administration or congressional legislation. Such policies can affect access to capital, labor laws, and environmental regulations. Moreover, these political changes can take place on federal, state, and local levels. Figure 14.11 lists several political factors that can influence a business. Tax reform law, for example, could influence the amount of taxes a business owes, while actions by the newly appointed chair of the Federal Reserve could affect how much capital may cost the small business owner because of interest rate changes.

SOME POLITICAL FACTORS INFLUENCING RESOURCES

- Tax laws
- Interest rates
- Protections/regulations
- Labor expenses
- Inflation
- Insurance costs
- Benefits costs
- Environmental laws

Figure 14.11 Businesses must follow all laws and regulations, but political factors such as the ones listed here can influence the profitability of the organization. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Recently, the 2017 Tax Cuts and Jobs Act changed corporate tax rates, as well as the payments businesses make quarterly to the Internal Revenue Service (IRS). Other changes included the expansion of certain deductions and tax credits (including which specific business expenses can be deducted), and a new method to depreciate assets, as well as other rules related to employees who help businesses receive credits and minimize taxes.[19]

Businesses must also follow environmental laws, such as those from the Occupational Safety and Hazard Association[20] and the Environmental Protection Agency (EPA).[21] For example, these government agencies require businesses to train employees about materials that may be hazardous to people and provide notices and reports on these matters. The EPA also has regulations on air and water emissions that businesses must follow, as improper disposals can harm the environment. Smaller businesses may be exempt from some of the regulations under certain circumstances.

Imported products are regulated by the federal government through quotas and tariffs. Tariff laws have been used as political instruments to manage the flow of goods between countries. **Tariffs** are taxes or duties that are added to imported goods from another nation. **Quotas**, a limit on the number of items entering a country, are also used to restrict the volume of goods entering a country. For example, the US government in 2019 imposed tariffs on $550 billion of Chinese products, while China has imposed tariffs on $185 billion worth of US products. While it is likely that this ongoing trade dispute will be resolved, free trade remains an ongoing source of international economic competition.[22]

For example, business owner Daniel Emerson, CEO of light manufacturer Light and Motion, described in a National Public Radio (NPR) interview that the latest round of tariffs on materials from China might push him to open a manufacturing plant overseas. Light and Motion manufactures lights for bicycles, headlamps, drones, and media production. According to Emerson, in order to get his parts from China, he has to pay the US government for importing them. He states that these tariffs might destroy his company, as his main

19 Internal Revenue Service. “The Highlights of Tax Reform for Businesses.” October 2018. https://www.irs.gov/newsroom/the-highlights-of-tax-reform-for-businesses

20 Occupational Safety and Health Administration, United States Department of Labor. n.d. https://www.osha.gov/about.html

21 US Environmental Protection Agency. n.d. https://www.epa.gov/

22 Dorcas Wong and Alexander Chipman Koty. “The US-China Trade War: A Timeline.” *China Briefing*. October 12, 2019. https://www.china-briefing.com/news/the-us-china-trade-war-a-timeline

competitors in China and other countries don't face those tariffs; therefore, his prices are forced higher. Emerson might have to move his company to the Philippines, which has no tariffs. He'll have to build them there and ship the completed lights to the United States.[23] As an entrepreneur, you should remain aware of political issues that may impact your operations and planning.

Economic Factors

Entrepreneurship has a direct impact on the economy by providing employment opportunities to many people. However, economic factors can also affect the success of a business. For example, they can deter customers from purchasing goods and services due to an economic downturn. On the other hand, when the economy is expanding and growing, people tend to feel confident about their jobs and income, and they may spend more than usual. **Economic factors**—which include inflation rates, interest, currency exchange (if the business operates or engages globally), state of the economy (growth or decline), employment rates, and disposable income—can impact the business owner's pricing of goods or services, the demand for such services, and the cost of production.

Taking the state of the economy, for example, when the economy is down, restaurants will see a decline in clientele as more people prepare meals at home to save money, or they will switch from fine dining restaurants to more casual or fast-food restaurants. In weak economies, consumers tend to purchase store (often called "private label") brands more often than national brands to reduce their grocery bill. When the economy is healthy, consumers spend more on entertainment and restaurants, which can be considered luxury items. The restaurant will need to adjust its resources to meet the economy-driven fluctuating demand. When demand is high, it is likely that the restaurant will need more supplies and more employees. These needs, in turn, result in the restaurant needing additional financial resources to buy more supplies and to pay employees. When demand is low, the opposite is true.

Sociocultural Factors

Knowing about your customers is key to delivering what they really want. Additional factors that need to be taken into consideration include changes in how society is moving and the direction of that movement as it relates to your customer base and potential new markets. These **sociocultural factors** include population growth rates, changes in where people live, social trends such as eating healthier and exercising, education levels, generational trends (millennial, baby boomer, or Gen X and Y), and religious culture. These factors can affect not only the seven Ps you learned about in the Entrepreneurial Marketing and Sales chapter, but also resource assessment more specifically. It is necessary to look at these factors closely in order to allocate marketing resources optimally. For example, if you are opening a restaurant and you see an increasing trend in healthy food, you may want to allocate your resources to fresh ingredients or more vegetarian and vegan options.

One far-reaching sociocultural factor is the impact that digital shopping has had on brick-and-mortar retailers. This online shopping trend has forced long-established companies such as JCPenney, Payless, Gap, Victoria's Secret, Radio Shack, Macy's, and Sears, to close thousands of stores, file for bankruptcy, or shut down the business altogether. These companies have faced enormous competition from entities such as Amazon and smaller businesses such as ModCloth and Birchbox that interact with customers virtually and stay on top of

23 National Public Radio. "U.S. Tariffs on China May Force California Company to Move Production Overseas." *All Things Considered*. September 24, 2018. https://www.npr.org/2018/09/24/651221317/u-s-tariffs-on-china-may-force-california-company-to-move-production-overseas

societal trends. Younger generations such as the Y and Z generations have triggered these social changes, as they are technologically savvier and expect to find exactly what they want, where they want it, and when they want it.

Technological Factors

In the case of **technological factors**, the enterprise needs to be sure it has equipment that allows it to operate efficiently. There are different types of technology that help with marketing, finances, productivity, collaboration, design, and production.

Being able to use technology to meet the needs of the customer, such as having an informational or an e-commerce website (so the customer can purchase from the comfort of home) is a “must” these days for most ventures. Digital marketing has allowed entrepreneurs to promote their businesses in many different ways, through e-mail marketing, digital ads on search engines such as Google or Bing, websites, social media groups, YouTube videos, and blogs. These tools are easy to use, available, and can be affordable, even on a shoestring budget.

WORK IT OUT

Social Media as a Resource

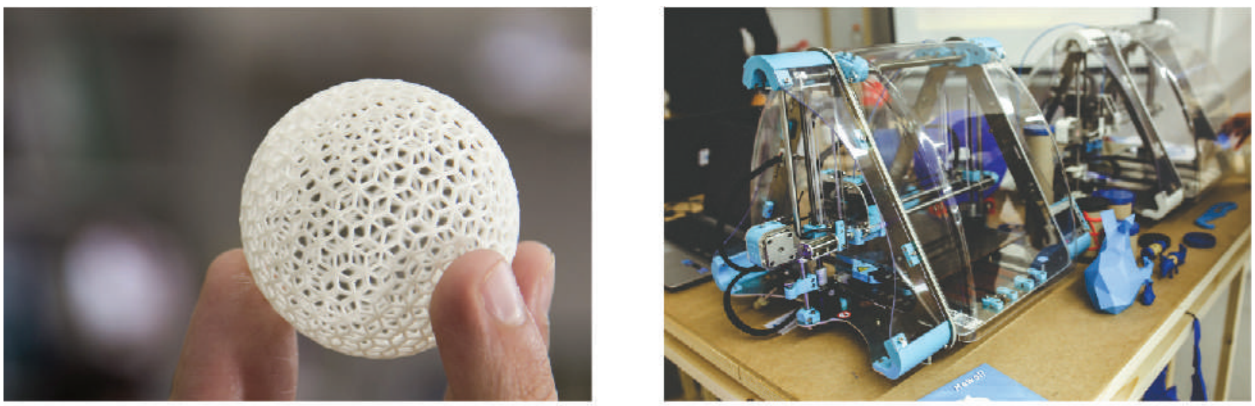
Leveraging social media technology is essential to building your brand and awareness in today’s digital society. Create an idea sheet for a Facebook page for your Helios solar panel enterprise, which was mentioned earlier in the chapter. What are the types of information you want to include? Do you want the page to be operational or just informational? Will this social media tool be used as the main source for customers to learn about your business or will it be a supplemental tool to create deeper relationships?

Other technology can also be helpful in managing payments from customers, billing, human resources payments, and keeping the books. QuickBooks is a popular software program that a starting entrepreneur can purchase and use to manage the company’s financials. Other products are available too—ZOHO Books, FRESH Books, GoDaddy Bookkeeping, and Kashoo—each has pros and cons.

Other types of software such as UAttend help small businesses keep track of their employees’ time and productivity, and Basecamp helps entrepreneurs keep track of the projects that everyone is working on, while allowing them to collaborate with each other and keep track of what is happening. These tools can make it easy for an entrepreneur to manage a project with contractors or employees.

Other technology that needs to be taken into consideration if you are manufacturing a product includes the tools and equipment that will create goods and services. Some examples are CAD (computer-aided design), 3-D printing for developing quick prototypes (Figure 14.12), CAM (computer-aided manufacture), robots, and new materials that allow faster and cheaper production of goods. 3-D printing, for example, is a manufacturing process that uses a technique of adding layers of material to create rapid prototypes. It can be used to create prototypes of products, toys, architectural models, prosthetics, tools, fashion, automotive parts, and even final products like homes, as in the case of New Story.[24] The use of prototyping allows for creativity, and these newer technologies allow users to create many prototypes. Nike, for example, uses 3-D printing to make their prototypes because it is faster than waiting for a full prototype to go through the manufacturing process. Using these technologies for prototyping can also avoid the expense of building the actual product, allow for the final product to be refined quickly, and help in the reduction of manufacturing errors.

The drawback is that some of these technologies can be expensive to purchase, and it can take a long time to recuperate the cost. (However, when wages and benefits costs rise quickly, they can pay for themselves rather quickly.) Entrepreneurs must be sure to acquire only those tools and materials that will help them get started. Then, as the business thrives, more funding is available for more expensive equipment and software Entrepreneurs then need to have the skills and knowledge to operate specific software and consider upgrades and replacement costs. Questions include: What about support services? How long will support last? If the entrepreneur updates the PC, will the old software run on the new operating system? Can the data be easily copied to the new operating system or software program?



(a) (b)

Figure 14.12 3-D printing allows companies to develop prototypes quickly before investing substantial resources. (a) A 3-D sphere, for example, can be created using (b) a 3-D printer. (credit (a): modification of "ball 3d printing design" by "metalurgiamontemar0"/Pixabay, CC0; credit (b): modification of "3d printer printing technology" by "kaboompics"/Pixabay, CC0)

Assessing Resource Costs for Startup

Starting a business can be an exciting event, and one that requires thoughtful planning. Resource planning can help determine start-up costs, which helps determine an estimate of breakeven sales, profits, what types of funding to use, and how to plan for future expenses like tax payments. According to the SBA business guide,[25] there are several steps you should take to determine startup costs for different types of businesses.

First, figure out the type of business you want to open: brick and mortar, online, or services. Brick-and-mortar businesses have physical locations where a customer may purchase a product in one or several locations. Online businesses operate through e-commerce websites and sell products and services virtually. These may or may not also have a physical location. Service businesses provide services rather than a tangible product. Also, consider the type of business structure you will have (see Business Structure Options: Legal, Tax, and Risk Issues).

24 "What Is 3D Printing?" *3DPrinting.com*. n.d. https://3dprinting.com/what-is-3d-printing/
25 US Small Business Administration. "Calculate Your Startup Costs." n.d. https://www.sba.gov/business-guide/plan-your-business/calculate-your-startup-costs#section-header-6

Next, make a cost list like the one in Table 14.5. There could be additional costs based on the resource needs identification discussion in Types of Resources. Many of the costs will be easy to determine, but others—like salaries, insurance, and improvements—might be more difficult to estimate. You can consult research sites, local business resources (such as the chamber of commerce), or speak to mentors or consultants (such as SCORE) for more guidance on how to estimate these numbers. Also see Building Networks and Foundations to see how industry professionals can help determine startup costs (Table 14.5).

Examples of Common Costs Related to Starting a Business

Types of Costs	Examples for a Fictional Marketing Consulting Firm
Physical space for an office, building, factory	10' × 15' office space downtown building
Real estate, land	None
Furniture and fixtures	Two small desks, six chairs
Inventory	None
Equipment and supplies	Computers, color printer/copier/scanner, paper, ink, office supplies
Vehicles	Personal cars
Utilities	Electric, heat/air conditioning, water, cell/Internet
Rent/utility deposits	Rent, utility deposits
Licenses and permits	Business LLC license
Insurance for business and vehicles	Owned personally
Accountant and lawyer fees	Accountant and lawyer
Employee salaries and wages	One part-time assistant, one web developer
Advertising and promotion	One radio commercial
Market research	Customer databases
Printed marketing materials	Stationary, brochures, business cards
Digital marketing	Website, social media, e-mail marketing
Memberships	Chambers of commerce/networking groups

Table 14.5

Determine the estimated cost for each item. Once the list has been developed, finding out what each of those items costs will allow you to make an estimate of your basic needs. A good source of information is the US Bureau of Labor, which publishes a list of occupations and their wages and benefits by location and profession. Some costs may have a range to consider, and a decision tree such as the one shown in Figure 14.6 may be helpful. Many state governments have a labor and workforce department that tracks wages and employment data for specific industries and professions on an annual basis.

After you have identified all of the costs, determine which ones are one-time costs (pre-launch costs) and which will be ongoing costs (typically monthly, quarterly, or annual). **Pre-launch costs** include everything you must have before opening the door of your business to the public. These include licenses and business permits, marketing materials, equipment, and inventory. Ongoing costs, on the other hand, are recurring. These may include rent, utilities, certain ongoing marketing costs like digital ads, and salaries. It is suggested to have at least one to two years of saved monthly expenses to make sure you give the business time to create a brand and a customer base. Add up your total pre-launch costs and your monthly costs to identify of how much capital you will need to start your business.

You should include this information in the financial section of your business plan. This data can help provide a clear picture of expenses and future revenues that banks and venture capitalists may find useful in making decisions about investing in your business.

Startup costs — Joe's Pizza Place

This worksheet is set up for a fictional business, Joe's Pizza Place. Use it to get started calculating the startup costs for your own business. Change expense categories or add new ones to fit your business. Enter one-time and monthly expenses in the appropriate columns. Your estimations should go into the Budget column, and the exact amount spent should go into the Actual column. Total funds required is the total estimated amount you need to start your company.

One-time expenses	Budget	Actual
Rent		
Security deposit	1,200.00	
First month's rent	1,200.00	
First month's utilities (including phone and Internet)	250.00	
Improvement costs		
Kitchen improvements	800.00	
Tables and furniture	1,500.00	
Utensils, dishes, and kitchen and bar equipment	350.00	
Inventory		
Food	1,250.00	
Beverage	700.00	
Alcohol	900.00	
Miscellaneous		
Licenses and permits	150.00	
Legal fees	300.00	
Signage	550.00	
Technology	300.00	
Software	400.00	
Total one-time expenses	**9,850.00**	**0.00**

Monthly expenses	Budget	Actual
Rent		
Monthly rent	1,200.00	
Property insurance	300.00	
Utilities	250.00	
Employees		
Payroll	3000.00	
Payroll taxes	1,250.00	
Health insurance	650.00	
Professional services		
Accounting	200.00	
Legal	250.00	
Consultants	200.00	
Other	50.00	
Supplies		
Office supplies	150.00	
Operating supplies	200.00	
Marketing		
Digital advertising	350.00	
Promotional materials	400.00	
Miscellaneous		
Liability insurance	400.00	
Repairs and maintenance	200.00	
Organizational dues	75.00	
Total monthly expenses	**9,125.00**	**0.00**

Source: modification of "Startup Costs Worksheet." Small Business Administration (SBA). n.d. https://www.sba.gov/sites/default/files/2017-07/Startup%20Costs%20Worksheet.pdf

Figure 14.13 This template from the Small Business Administration (SBA) is designed to help you capture the one-time and ongoing costs for your resource needs. Adding your total one-time expenses to your total monthly expenses will help you calculate your start-up costs (you should generally plan ahead for a few years of monthly expenses). (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

ARE YOU READY?

Specialty Pizzeria Costs

Imagine that you are interested in opening a pizza parlor in your town. Your idea is to provide specialty dietary choices such as vegan and gluten-free pies in addition to regular pies. You would like to open it in a new, busy shopping area where you can reach your target market.

Download the SBA's business worksheet to figure out your one-time and monthly costs for your business: https://www.sba.gov/sites/default/files/2017-07/Startup%20Costs%20Worksheet.pdf.

14.3 Managing Resources over the Venture Life Cycle

Learning Objectives

By the end of this section, you will be able to:

- Explain how resource dependence theory helps a venture grow
- Understand typical resource needs through the life cycle
- Describe the basic steps in securing human resources
- Understand the importance of educational and personal resources to the entrepreneur

The evaluation of needed resources does not end with the startup phase. This is an essential activity that the business owner must engage in throughout the life cycle of the business. Many entrepreneurs have failed to re-assess how their needs have changed as industry, technology, economic, political, or social changes emerge in the marketplace. This lack of timely assessment of operational needs can result in business struggles or even failure. Business owners need to be engaged in ongoing research, monitoring of the external environment, ensuring they have the ability to easily respond to changing circumstances.

When Birchbox, a business covered in Entrepreneurial Marketing and Sales, first entered the cosmetics sales market through an innovative business model, the founders (Katia Beauchamp is pictured in Figure 14.14), were able to fund their startup through venture capitalists who saw a great opportunity to tap into a new model of selling cosmetics. After it had been in business for a while, Birchbox grew not only in customers and employees, but also in competitors. The company struggled with cash flow as it grew its customer base and struggled to keep a healthy profit due to its tight margins from selling other brands' items. After talks of selling to QVC and Walmart, Birchbox sold its ownership to an internal investor who provided the cash for the company to continue to innovate its products and digital processes, and to add more cosmetic partners.[26]

26 Jason Del Rey. "Birchbox Has Sold Majority Ownership to One of Its Hedge Fund Investors after Sale Talks with QVC Fell Through." *Vox*. May 1, 2018. https://www.recode.net/2018/5/1/17305940/birchbox-recap-viking-global-qvc-merger-sale

Figure 14.14 Katia Beauchamp, owner of Birchbox, will stay at the helm of the company with the help of a hedge fund investor. (credit: photo provided by Birchbox)

As we can see from the Birchbox example, business operations are impacted by various internal factors such as increases in the customer base, employee growth, as well as changes in marketing needs and external factors, which include fierce competition that can curtail the venture's productivity, impact competitive advantage, or limit its access to key resources. In the case of Birchbox, cash flow was necessary for product innovations and digital marketing changes to combat their competition.

To counteract some of this, dependencies can be formed with others in a network of enterprises. This can aid in circumventing the impact of external factors such as an increase in competition in their respective market, limited ability to obtain credit for capital resources, shortages of the raw materials needed to produce their goods, or human resources to meet demanded service and production levels.

For example, many businesses within a particular industry are dependent on the same purchasers, vendors, raw materials, or other environmental resources. The **resource dependence theory (RDT) model** posits that forming networks such as mergers, vertical integrations, and joint ventures, or engaging in joint political activities, can help mitigate dependencies among member groups.[27] This classic model remains relevant today.

As Launch for Growth to Success discussed, mergers occur when two companies have the same specific goal and create a contract to become one company, with the shared goal usually of gaining new customers, growing market share, improving purchasing power, or reaching new markets.

In vertical integration, a company acquires members of its supply chain, which helps gain economies of scale, improve deliveries of inventories, reduce costs, and may also stifle competition.

A joint venture (see Business Structure Options: Legal, Tax, and Risk Issues) can be less taxing to the companies involved, as each of them retains their identities and management teams while pooling their assets to create synergy through a new project or engagement in political activities. Being able to gain control over their external environment through these alliances is essential to aid a small business toward growth and sustainability.

In the case of Birchbox, there could be a time when a cosmetics brand and Birchbox could merge to create a new line of products, or Birchbox could acquire one of its cosmetics brands in vertical integration. However in more recent years, cooperative ("coop") arrangements have emerged to help small businesses share

27 Pfeffer and Salancik. *The External Control of Organizations: A Resource Dependence Perspective* (Stanford: Stanford University Press, 1978).

resources collaboratively based on a common interest and trust. For example, Community Supported Agriculture is a popular way for farmers and other commodity growers to gain selling power through their combined efforts.[28] In particular, Red Hen Bakery, a small artisanal cheese making company in Ontario, has supported its business by partnering with both local pig farmers and craft breweries to help manufacture their cheeses. They also sell vouchers to customers in advance to help manage seasonality.

In another example, farmers have turned to commercial aerial drones to help assess their crops' viability and optimize their use of fertilizers, irrigation, and other resources. Consulting firms have emerged to provide these monitoring services, despite the constraints that the Federal Aviation Administration (FAA) imposes on commercial drones. These common interests have helped them lobby the Farm Bureau and other trade associations to accelerate FAA permits for this type of commercial use.

WORK IT OUT

Auntie Anne's Pretzels and Strategic Partnership

Visit Auntie Anne's Pretzels (https://openstax.org/l/52AuntieAnne) to learn more about their story.

- Write a summary on how Anne Beiler leveraged relationships in the initial launch of her business.
- What strategies did Beiler use to identify strategic partners, resources and processes to protect her profitability?

Resources Needed Based on Life Cycle

Entrepreneurs need to identify and plan for their resource needs (Table 14.6) and costs for all stages of the venture's life cycle, which is shown in Figure 14.15. Evaluating the cost of the enterprise at each phase for both a good and a service helps the entrepreneur assess its feasibility (see the discussion on funding at various life cycle stages in Entrepreneurial Finance and Accounting).

28 "The Growth of Community Supported Agriculture. *Morning AgClips*. February 7, 2018. https://www.morningagclips.com/the-growth-of-community-supported-agriculture/

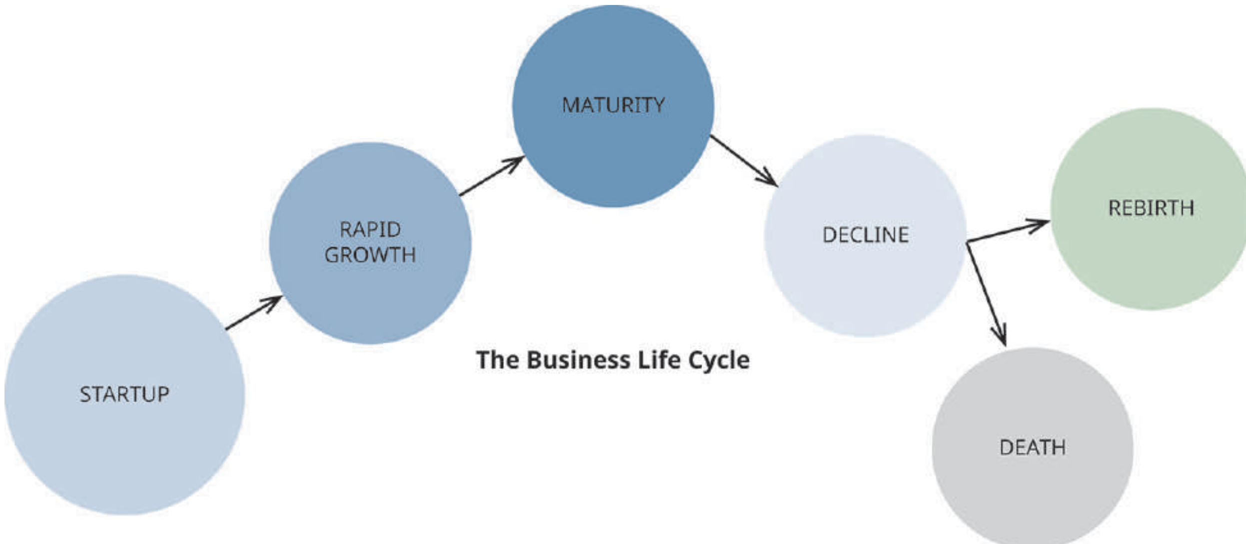


Figure 14.15 Entrepreneurs and business owners should plan for resource needs and their associated funding across all phases of the business life cycle. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Startup Phase

The startup phase is an exciting and exploratory time for the entrepreneur. In this phase, ventures are defining their identity, growing their customer base, learning more about their target market and how best to serve it, how to develop the products that will meet demand, and how to hire the people that will make it all happen. At this time, resources are often scarce, and the entrepreneur may be bootstrapping to keep costs low. This means that the entrepreneur might be working from home to save on rent and utilities, and may have only a part-time employee or none at all. The product may be created on a single piece of equipment that can produce on only a small scale. When a product is first developed, there are also costs to consider. These include costs of raw materials, production, packaging, and personnel for the production, or what is commonly known as *cost of goods sold*. Recall that the cost of goods sold is the accumulated costs of creating a product (materials, direct labor) or a service (direct labor). At introduction, there is packaging, marketing, promotions, and shipping, and, if inventory is maintained, warehousing.

Any sales revenue is immediately re-invested into the business with the aim of developing a cycle of growth. The entrepreneur at this point may forgo a salary while the business takes off and may also wear many hats to keep the ball rolling instead of hiring employees.

Advisory boards are crucial during this phase, as they bring current information to the table to inform entrepreneurs of trends, changes, or regulatory adjustments within the industry that could affect their enterprise. An **advisory board** is a group of knowledgeable people who aid an organization to make strategic decisions about the business and its issues without having the power to vote or make any legal decisions. Having access to key contacts, networks of professionals, and public resources are key to having a current toolkit from which to draw information to inform decision-making and resource management.

In the case of Christina's Confections, she started baking goods at home with her own oven. She did quite a bit of bootstrapping and used her savings to buy ingredients, utensils, packaging materials (boxes and containers), marketing materials (flyers, brochures, business cards), and a basic website, and to pay a part-time employee. For two years, Christina didn't collect a salary so she could save money for the next phase, which is growth.

Growth Phase

During the growth phase, the business has been around for a few years, its identity has been developed, its customer base has grown, sales are accelerating, and there is a need for more resources to sustain this growth. Resource needs can take the form of cash to invest in new equipment, new materials, more marketing, or new personnel. Additional equipment may be needed to help with a higher output, or perhaps the current location is too small to produce at a larger scale. The location might not be big enough for customers, or to welcome guests, so a new building may be required. More material might also be needed to create more products due to higher demand, and more people may need to be hired for production. There may be a need for management and administration to expand as the organization grows, too. Departments may now evolve and require processes to coordinate efforts between functions such as production, human resources, and marketing.

LINK TO LEARNING

Take a look at this checklist for growing a small business (https://openstax.org/l/52SmallBusCheck) from Visa and SCORE. Review the seven steps that address key issues that can affect business growth.

During the growth phase, the entrepreneur might need to change marketing strategy, advertising, production, or even packaging to keep up with demand.

Let us revisit Christina's Confections bakery. Two years into operations, she needs to identify a larger location for her bakery. She now has ten employees and has several corporate accounts she services for special events. She recently partnered with a neighborhood catering company and has been retained to provide the baked goods for their catered events. These changes mean that Christina will need to obtain funding for the expansion, locate a space near her existing location, or expand on the location she is currently leasing. Part of her consideration at this point is determining if it is feasible for her to purchase a location, which would allow her to gain all the benefits of facility ownership as she often works long hours and needs flexibility for access. The ideal location would be one in which she could reside above the storefront so she can incorporate living expenses into her monthly expenses.

Maturity Phase

In maturity, when the product has perhaps saturated the market and there may be lower-cost alternatives, the entrepreneur has to deal with competition as sales level off and more companies are fighting for customers' dollars. At this point, spending resources in branding becomes very important, as customers have many choices available to them and having a reputable image and uniqueness as well as a brand that inspires brand loyalty helps businesses attract them.

As needs change with this growth, the entrepreneur must reconsider the resources, operationalize how these are used, and determine what efficiencies may be gained by retaining certain resources and outsourcing others. **Outsourcing** is the activity of hiring an outside company or third party to perform a specific task, job, or process, or to manufacture goods. This is common in human resources, where many companies outsource their workforce to reduce costs and focus on retaining tasks they excel at.

For example, if you are a digital marketing company and have several web design projects you are working on, outsourcing can help you pass some of the most challenging tasks in the design or coding process to another company, while your venture focuses on the steps in the process that are your company's strengths. Similarly, another company could seek to use your company's resources if they believe your company has a greater proficiency for specific tasks.

Decline/Rebirth Phase

During the decline phase of a business, if there is to be rebirth, resources must account for making changes to the product so it can have its renaissance. In Christina's case, if the traditional bakery industry were to decline, she could decide to use different ingredients and equipment to make a new kind of cake that uses only fruit and vegetables, or something completely different that would ensure the business would still be unique enough to come back to the life cycle. Most companies that have lasted many years in business have gone through this cycle several times and have been able to reinvent themselves. Small bakeries, clothing chains, and car manufacturers have been able to "come back" within industries that are easy to fail in due to their decline. Also, many tech companies such as Apple, Nintendo, and Polaroid were once in the decline phase, but their ability to shift allowed them to have a rebirth.

Summary of Resources for Each Phase of Business

Business Phase	Resources Needed
Startup	Initial capital, basic equipment, inventory, few employees, facility (home or location), cost of goods sold, marketing materials, mentorship
Growth	More capital, additional employees/departments, marketing, additional equipment, inventory
Maturity	Branding, outsourcing
Decline/ Rebirth	New equipment/technology, new products, new patents, equity funding for possible merger

Table 14.6

Human Resources

As you begin your entrepreneurial journey, you will realize that you cannot do everything on your own. You will need people to help. In the beginning, you may need office assistance or production assistance, and, initially, they could be part-time hires. As you grow, though, you will realize that you need to have a more sophisticated understanding of how to build a skilled workforce. **Human resources** are the people needed to support the current and future growth of the venture, and help the company increase production and the provision of services, as well as help with the administrative tasks required to operate the business. Employees add value to the enterprise in that they help the business generate revenue. Having the proper staff is a constant process that must have procedures in place and starts with having a plan set out to recruit and hire the people with the skills that match your venture's needs. In addition to hiring, a small business owner can consider getting human resource help through partner firms, outsourcing, and even outside consultants who are not actual employees of the company but provide support or specialized services for the company. Building Networks and Foundations discusses building a team. Here, we focus on the essentials of the human resourcing process.

First, figuring out why you need the help is an important step in assessing the needs of the company. Usually, entrepreneurs will need some sort of part-time help managing an office, manufacturing a product, or producing a service. The need and the outcome must be greater than the cost of hiring someone. This assessment ensures that current revenue can cover the addition of another person's compensation. For example, you may need to hire a part-time assistant who would cost $15,000 to $30,000 a year. If having that part-time assistant frees you up to sell $50,000 of product, then it is financially worth hiring that person. In addition, if you hire a salesperson at $40,000 to $50,000 per year, including benefits, and they sell $100,000 a year for you, then it is worth hiring that person because they are generating profit. Keep in mind that many entrepreneurs start with virtual assistants, bookkeepers, designers, web developers, or managers who can vary in price and only work when you need them. Using sites such as UpWork to hire freelancers to cover a portion of your business allows you access to dozens to hundreds of choices to find a resource that works for you, often at lower costs than hiring someone on staff.

Once you establish that hiring new employees is a need and a smart financial choice, you need to create a job description to attract the right candidates. This contains a statement of the employee's tasks and responsibilities, the processes used, and the desired outcomes. It will also include the parameters of how the job will be done, the environment, the hours, and the skills and experience necessary to perform well.

In preparation for determining your hiring needs and creating job descriptions, the following steps will guide you on topics and decisions to consider. After determining your resource needs, the remainder of the steps can occur in varying order depending on your specific situation.

Step 1: Determine Resourcing Needs

Understanding the needs of your business in terms of job functions is the first step to hiring. Defining the work that needs to be done based on your business strategies can help guide your business needs. If you are a business consultant and need help managing the office, you can make a list of all the needs of the upkeep of the office. This can include answering phones, setting appointments, attending customers, making copies, paying bills, and ordering materials.

You will also need to determine whether you need full-time or part-time people, and what the budget is to clarify the direction of your hiring. Making a list of the tasks or goals for the business and estimating the time that it will take to finish them can help decide to hire a part-time or full-time person.

Keep in mind that needs may change, so even if you made a plan, the execution may vary, and you may need to make changes. By determining your costs and the benefits of those costs, you can figure out how many people you can bring on to accomplish the goals set in your business plan or marketing plan. If your plan calls for having sales of $100,000 the first year, you might want to hire one part-time employee at $25,000 who can help you achieve that goal. If your goal is to have sales over $1 million, then you likely might need more employees.

Figuring out what skills and experience your team should have is a good starting point for developing the job description, and setting the salaries and benefits you will offer. Once you set your descriptions and post them, whether online, at a job fair, or in a newspaper, you will see the applications coming in. If your industry calls for more sophisticated experience and skills, you may also want to hire a staffing agency to help you with the hiring.

Step 2: Hire a Team

Hiring a team of employees can be a daunting task, but if you first focus on understanding the needs of your business and the amount of time required to perform those tasks, this step will be a lot easier (Figure 14.16). It involves setting up the job description, deciding on a salary and benefits to pay, posting it on various job websites such as Indeed.com, careerbuilder.com, or monster.com, and any industry job portal that may be important to reach qualified people. Oftentimes professional networking—such as online sites like LinkedIn or local groups like your chamber of commerce—may result in additional leads. The alumni center at your local university or community college may also be a place to connect with qualified candidates. Technology schools or trade schools are excellent sources to find skilled workers looking for that first full-time job after earning certification or licensing.

Figure 14.16 Hiring the right employees for your business will ensure that they will help you start and grow the company. (credit: “job interview hiring hand shake” by “Tumisu”/Pixabay, CC0)

Once posted, you must decide how long to advertise the position. Also consider that the interview process can take a few days, weeks, or months, depending on how many people you are hiring and the quality of your prospects. If you are satisfied with the process, then you select the employee(s) and inform them of your selection. But before you extend an offer, you might want to conduct a background check first and then offer and welcome them into your team. Conducting background checks, including criminal checks, should be a routine procedure in the hiring process. A formal job offer should never be made until the results of the background checks have been received and reviewed. If a potential candidate accepts a job offer and you are then required to withdraw that offer because results of a background check disqualify the candidate, many problems will be unnecessarily created.

LINK TO LEARNING

Before conducting any interviews, you should be aware of which questions are legal and which are not legal (https://openstax.org/l/52LeglInterview) to ask in an interview. Minnesota State Colleges and Universities website offers a repository of appropriate questions.

Step 3: Create an Employee Handbook

If you're starting your business from scratch with no sales, it is likely that you will only need one or two part-time people to help you with your business. An employee handbook at this time may not be necessary; however, once you have ten or more employees, and your business begins growing, you will want to create company employment policies and rules for all employees to follow. You could also create this handbook at the inception of your business. This handbook is a road map that may include rules about how to act as representatives of the business, attire expectations, hours required to work, proper etiquette, legal and regulatory compliance for full- or part-time employees, and sanctions for when these rules are not followed. Most companies today also need to create policies around social media use and statements made online via social media. Listing any benefits such as earned vacation, paid time off for jury duty, holiday pay, personal time off, and price discounts for employees and family members should also be included. Sometimes in filings for unemployment, the state workforce commission will require a copy of the employee handbook to help determine what the former employee is entitled to receive. Having written policies in a handbook and following them can save a lot of time and protect against conflicts with employees.

LINK TO LEARNING

Some companies have begun to create funny and memorable handbooks (https://openstax.org/l/52Handbook) to entice employees to read them and understand them.

Step 4: Secure Independent Contractors, if Necessary

As covered in Building Networks and Foundations, sometimes looking outside of your business to get help can be a good idea while building or growing your venture. **Independent contractors** are people who provide work without being part of the payroll for the contracting business. They may perform work similar to employees, but they are not employees of the company; therefore, the business does not have to pay for benefits or withhold taxes. However, these workers set their own time for work, can come and go as they need to, use their own equipment to complete assigned tasks, and can perform the work in their own way, as a service provided. You may want to consult with an accounting expert in tax issues before beginning work with independent contractors.

LINK TO LEARNING

Take a look at this checklist to determine whether a human resource should be considered an employee or an independent contractor (https://openstax.org/l/52ContractCheck) from the IRS. The distinction carries important legal implications, and the burden is on the employer to make the correct classification. Failure to classify workers correctly can be an expensive mistake.

Step 5: Establish Benefits

When designing a position and hiring people, another important consideration is the benefit plan you will offer. Common benefits include contributing to or providing health insurance costs, paid vacation time and sick days, providing access to 401K retirement accounts and contributing to them on the employee's behalf, and insurance—including life, long- and short-term disability, and accident insurance. In addition, you might want to offer stock options to provide employees with a piece of your business and entice them to work for a company that they own. Each of these benefits is subject to state or federal regulations, or both. Seeking advice from professionals on these issues would be a valuable use of the entrepreneur's time and money. Getting these employee benefits wrong can doom a company quickly.

LINK TO LEARNING

Visit the Society for Human Resource Management site for examples of benefits and how to implement them (https://openstax.org/l/52Benefits) to learn more.

Once employees are on board, there is an ongoing process of training, promoting, and managing them, as well as developing relationships that will be key to the success of the enterprise. In the evaluation of human resources, you may need to consider these questions:

- Are the skill levels that I need available in the region where I plan to operate?
- What is the prevailing wage for the human resources I need?
- How much can I afford to pay employees at this phase in my business?
- Are independent contractors the best option or are employees a better fit?
- Will I need to provide ongoing formal training or maintain certifications or licensures for my staff or are employees responsible for these items themselves?
- How can I be competitive with other business to attract the talent I need?
- Will I need to provide benefits such as vacation, retirement plans, health insurance, or life insurance?

Educational, Support, and Mentorship Resources

Entrepreneurs need to be mindful not only of the resources needed to operate the business, but also of the resources needed to support them in their challenging role of being an entrepreneur. Ongoing education and mentorship are key supports. When entrepreneurs are asked what topics they need learn more about when starting and growing a business, often they request more educational support in management, leadership, communication, financial, and marketing education. Many owners are experts at their craft but don’t know how to manage the business itself and must take courses or earn certificates to gain that “how to run a business” knowledge. Local chambers of commerce and other organizations provide training sessions, workshops, and educational programs in marketing, communication, management, and leadership. Other needs include finance, accounting, and software use. The SBA has a learning center where business owners can learn about many topics from how to write a business plan to the legal requirements and financing options that apply to their venture.[29] One important topic they address is digital marketing, a training most entrepreneurs need in this day and age. The Small Business Development Center and SCORE are organizations that also provide myriad workshops at no cost or for a very small fee.

Although some entrepreneurs do have business degrees and a few have advanced degrees, they still need to keep abreast of trends and changes in their industry. They have to continually educate themselves through various forms of research, by attending conferences, and through programs available through the chambers and other organizational networks. Maintaining a subscription to a major industry newspaper or trade magazine can be extremely beneficial. Another common trend is for starting entrepreneurs to work in the industry of their business to acquire the skills and knowledge necessary before they embark on their journey. For example, if you want to open a digital marketing business, you might first gain some experience by working for a digital marketing company prior to opening the business. However, you should make certain you abide by any noncompete or similar clauses in your employment contracts.

As we have seen throughout the text, being an entrepreneur is no easy task. It requires many hours to start and grow a business, not to mention the daily stressors from challenges that arise from interactions with employees, customers, and suppliers. High-performing entrepreneurs must have a good support system to help them overcome the ups and downs that owning a business might bring.

Having friends and family members who are supportive of the venture is important because these are people the owner trusts with personal and work issues on a daily basis. Their support is key to the success of the entrepreneur as they listen and understand the frustrations of being in business and may also help with the business itself. By the same token, the entrepreneur needs to spend time with friends and family to bring work-life balance to their lives.

Having mentors who have gone through similar issues and can listen and advise is a great advantage to entrepreneurs. Mentors act as counselors to the business and are genuinely interested and happy to help the business owner. Most mentors have been through similar challenges and have great knowledge and passion about the industry in which they work. SCORE can be a strong network for finding a mentor. This program is a partner of the SBA and provides free education and mentors to business owners. The mentors are volunteers who have many years of experience and now want to help other businesses for free. You can go to their website (https://www.score.org/) and type in your zip code or industry to find a mentor near you. Doreen Graves is an example of a marketing mentor in northeast Mississippi who feels that she is not only a mentor to her mentees, but a support system and confidante, as they share with her their most personal stories of struggle, family values, and business dreams. She feels fortunate to have the power to help them.[30]

29 US Small Business Administration. “Learning Center.” n.d. https://www.sba.gov/learning-center
30 Service Corps of Retired Executives (SCORE). https://www.score.org

WHAT CAN YOU DO?

Take a SCORE Course

Go to SCORE (Senior Core of Retired Executives) and take a look at Become a SCORE Volunteer (https://www.score.org/volunteer). It outlines four ways to donate your time:

- Mentor: Offer confidential business mentoring services, either in person or online
- Subject matter expert: Provide focused knowledge based on your professional skills or industry
- Workshop presenter: Lead local workshops, seminars and events to help entrepreneurs meet their goals and achieve success
- Chapter support role: Share your skills in marketing, tech, finance, fundraising and more to help expand the outreach of SCORE

Which of these roles do you see yourself fitting into some day and why?

Key Terms

advisory board group of advisors that helps an organization make strategic decisions about the business, and brings certain knowledge and experience that can bring a new perspective on issues without having the actual authority to vote or govern

copyright grants the creator of a work the exclusive right to reproduce the work, typically for a specified period of time

decision tree flowchart diagram used to explore the outcomes of different decisions

economic factors inflation, interest, employment, and currency exchange, rates, (among many other factors) that impact the business owner's pricing of goods or services, the demand for such services, and the cost of production

funding sources monetary resources used by the entrepreneur in the operation of the initial startup and early business

human resources people hired by the entrepreneur to perform various duties in the business, provide customer service, or produce the goods

independent contractors (also, freelancer) people or businesses that provide work similar to an employee without being part of the payroll for the contracting business, and who pay their own taxes and pay for their own benefits

intangible resources assets that cannot be seen, touched, or felt, such as intellectual property, patents, designs, and processes

line of credit lending of funds in exchange for a promise to repay

outsourcing hiring an outside company or third party to perform a specific task, job, or process, or to manufacture goods

PEST framework that can be used to distinguish political, economic, sociocultural, and technological factors influencing access to needed resources

political factors stem from changes in politics, such as the policies of a new presidential administration or congressional legislation, as well as of state and local offices

pre-launch costs cost of all the resources needed to open the business to the public

quota specific number of units allowed into a country; sometimes quotas are limited to one source, such as one country, and sometimes the limit is placed on aggregate quantity regardless of source(s)

resource dependence theory (RDT) model creating networks with business partners through mergers, vertical integration, joint ventures, or engaging in joint political activities to slow dependency among member groups

service mark word, phrase, symbol, or graphic that identifies the origin or source of a service

sociocultural factors changes in how society is moving and the direction of that movement as it relates to a customer base and potential new markets

tangible resources assets that have a physical form as they can be seen, touched, and felt

tariffs taxes or duties that are added to imported goods from another nation

technological factors technological equipment and tools the enterprise needs to be sure it operates efficiently

trademark registration that provides the owner the ability to use a name, symbol, jingle, or character in conjunction with a specific product or service, and prevents others from using those same symbols to sell their products

Summary

14.1 Types of Resources

Determining which resources a venture needs is essential to its success. Assets are types of property that benefit the person or company in possession of them. They can be tangible or intangible. Tangible resources can be seen, touched, and felt. They may include raw materials, land, facilities, buildings, machinery, computers, supplies, furniture, information technology, and vehicles.

Intangible resources cannot be seen, touched, or felt. They include intellectual property such as designs, formulas, art, written work, brands, and inventions that can be protected by patents, trademarks, and copyrights.

Entrepreneurs oftentimes have novel ideas about how to provide a service or how to create a better product. These ideas are important to safeguard so other competitors don’t copy those same characteristics of a product, process, machine, piece of writing, or any other of the works cited earlier. A way to protect them is to ensure that you have a patent, trademark, or copyright so others cannot benefit from your work. It is always beneficial to do a check before applying for one of the protections and make sure that the invention hasn’t been created before. Searching the USPTO website and hiring an attorney will ensure you are the first one to register your idea and help you through the lengthy and often expensive process of protecting a new idea.

Funding sources are essential to starting and scaling a business. These include an entrepreneur’s own savings, bank loans, venture capitalists, angel investors, crowdfunding, and friends and family. It is important to consider the pros and cons of your financing options in relation to your resource needs in order to plan for short- and long-term needs.

14.2 Using the PEST Framework to Assess Resource Needs

Business owners need to know what resources they need before launching. The PEST framework can help you become aware of outside forces that affect the procurement of resources you need to succeed. PEST looks at the political, economic, sociocultural, and technological factors that affect resource costs and availability. Different businesses require different resources, so going through a checklist of basic needs, finding the associated costs, splitting them into one-time costs and ongoing costs, and adding them up will ensure the entrepreneur is aware and ready to document for an investor or bank the resources needed.

14.3 Managing Resources over the Venture Life Cycle

The life cycle of the business requires resource allocation and planning at each stage. These stages include the startup phase, growth phase, maturity phase, and decline/rebirth phase. There are instances where a business has failed because the owner failed to re-assess shifting resource needs caused by changes in the marketplace and the overall environment. Research is an ongoing process, and keeping an eye on the external environment allows a business to be able to shift on time.

Resource dependence theory (RDT) is a model that explores creating networks with other companies through mergers, vertical integration, and joint ventures. RDT can help counteract the effects of competing with each other by optimizing collaboration.

Human resources include the labor that produces a product or service, and provides administrative support and customer service. Having good employees adds value to the enterprise because they help generate sales and profit. Education in marketing, management, and leadership are important topics to engage in as a business owner as well as having personal support from mentors.

Review Questions

1. What types of tangible, intangible, and funding resources exist? Give examples of each.

2. What is an example of a tangible resource and an intangible resource?

3. What is the PEST tool? How can entrepreneurs use it to their advantage before launching a business?

4. Why is it important to figure out costs before launching a business?

5. What are examples of costs that must be taken into consideration before opening a business?

6. What is the difference between one-time costs and monthly costs? How much should an entrepreneur have of monthly costs in advance?

7. Define the resource dependence theory.

8. What is the life cycle of a business and how do resource needs and their associate costs shift over time?

Discussion Questions

1. Discuss how a small business can be bootstrapped at its inception. What kind of costs can the entrepreneur avoid or lower with tenacity and sweat equity?

2. If you were to start a small business, what would it be and what kind of resources would you need to get started?

3. Which do you think are more difficult to protect: tangible or intangible resources and why?

4. Discuss how political factors can impact a business.

5. What are some examples of sociocultural factors that may affect a business?

6. Explain how economic factors can increase the price of a product.

7. When is it a good time to hire an independent contractor and when is it a good time to hire an on-staff employee?

8. Explain how resource dependence theory helps a venture grow.

9. Discuss the steps required in hiring new employees. What sorts of factors must you think of before you hire a new team?

10. Discuss the importance of having personal resources, such as a strong support system, when starting a venture.

Case Questions

1. Christina has always wanted to open a small neighborhood bakery, Christina’s Confections. She is currently working out of her home, earning income making cakes and baked goods for weddings, parties, and other special occasions. She would like to find a location for her bakery, as she believes there is a market, and she would like to expand her business to a retail operation. She has some money saved and her credit is good, but she is concerned that obtaining a loan will be challenging. Sales have been consistently increasing, and she now has one part-time employee, but she thinks that with a retail location she will need to hire an additional two people on a part-time basis. If she does hire staff, she will need to consider the cost of labor, how many hours she would need each of these staff, and the tasks she would need them to perform at this stage in her business operation. As a result, she will need to consider their wages as a cost of labor on top of all the other supplies, insurance, rent, advertising, point-of-sale equipment, and various other costs she did not have when she was operating out of her home. She needs to figure out how she will make money and how she will finance or pay for her new start-up costs in the retail location.

Christina needs to evaluate all the resources she would need for this enterprise and create a checklist so that she can determine if the time is right for her to take this important step with her bakery. As she progresses through the process, the questions get more specific and the answers become much more detailed.

Review Christina’s resource needs and make a list of them.

2. Going back to this case question on Christina’s Confections, go over the list of resources that you created. Now that you have additional information, determine if that is a good list; if not, add or delete items that are necessary for her to run her business. What additional resources did you come up with? What can she do to ensure she can cover all her expenses?

3. Consider Christina’s Confectionaries bakery example and focus on the maturity phase of her business. Describe how Christina can develop her brand to distinguish her from other bakeries and what kind of costs she can expect to incur while doing this.

Suggested Resources

14.1 Types of Resources

The Business Journals company profiles: https://www.bizjournals.com/profiles/company

Circleup: http://circleup.com

Exilend: https://www.exilend.com

Fundable: http://fundable.com

Indiegogo: http://indiegogo.com

Kickstarter: http://kickstarter.com

LendingKarma: http://www.lendingkarma.com

LoanBack: http://loanback.com

NewsLink: http://www.newslink.org

Society of Human Resources Management: http://shrm.org

US Small Business Administration: https://www.sba.gov/

US Securities and Exchange Commission Regulatory Actions: https://www.sec.gov/rules.shtml

Trade Show News Network: http://www.tsnn.com

US Census Bureau: http://www.census.gov

Copyright Office: https://www.copyright.gov/

US Chamber of Commerce: https://www.uschamber.com/

US Patent and Trademark Office: https://www.uspto.gov/

ZimpleMoney: http://www.zimplemoney.com

SEC Information on crowdfunding portals: https://www.sec.gov/divisions/marketreg/tmcompliance/fpregistrationguide.htm

Link to SEC (FINRA) crowdfunding portals: https://www.finra.org/about/funding-portals-we-regulate

New York University, Stern School of Business: https://www.stern.nyu.edu/

Link to data on margins by sector: http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/margin.html

Loopnet: https://www.loopnet.com/

Bizstats: https://www.bizstats.com/

14.2 Using the PEST Framework to Assess Resource Needs

SBA calculation of startup costs: https://www.sba.gov/business-guide/plan-your-business/calculate-your-startup-costs#section-header-6

US Department of Labor: https://www.dol.gov/general/topic/statistics/wagesearnings

https://www.businessnewsdaily.com/5-small-business-start-up-costs-options.html

14.3 Managing Resources over the Venture Life Cycle

Referrals and Associations

Tradeshows: http://www.tsnn.com/

Industry research publications: http://www.newslink.org

National Association of Women Business Owners: https://www.nawbo.org/

University and Organizational Resources

Small Business Development Centers: https://www.sba.gov/offices/headquarters/osbdc/about-us

New York University, Stern School of Business: https://www.stern.nyu.edu/

Governmental and Other Agencies:

https:///www.bls.gov

https://www.census.gov/

https://www.sba.gov/

https://www.ready.gov/business/implementation/resource

https://www.usa.gov/laws-and-regulations

https://www.sba.gov/video-series/2_minute_video_series#363481

15 Next Steps

Figure 15.1 Consider the importance of having a source of light when the sky is dark, or when disaster strikes and electricity is lost, or for some people, when the infrastructure for electricity doesn't exist. Andrea Sreshta and Ana Stork identified this situation as an opportunity to create a new product that provides light when the infrastructure does not. (credit: modification of work by LuminAID)

Chapter Outline

Introduction

"How can you know what you're capable of if you don't embrace the unknown?"—Esmeralda Santiago

In 2010, two graduate students participated in a project to assist post-earthquake relief efforts for Haitians. These two students focused on the need for light. For most people, we turn on a light switch and seldom ever consider how important light is to our safety and extending our sight beyond dependence on the sun for daylight. Andrea Sreshta and Ana Stork analyzed the problems people have after a disaster and noticed that no one addressed the challenges of lack of light. Recognizing the opportunity to solve this problem, these two social entrepreneurs created a reusable solar powered light source, LuminAID.

Now that you have learned how to create a business plan and understand more about entrepreneurship, we turn to the challenges that many entrepreneurs face as they start their venture, with advice to help you overcome them and consider your next steps beyond the current venture's successes.

In this chapter, we consider some of the challenges faced by entrepreneurs along the journey, identify reasons why these occur, and discuss what we can do to avoid these challenges through proactive problem solving and understanding biases and habits that get in the way of our success. Some of the themes in this chapter include being open-minded, possessing a willingness to re-evaluate and adapt to new information, and avoiding mistakes through learning from past contributors to the field of entrepreneurship.

15.1 Launching Your Venture

Learning Objectives

By the end of this section, you will be able to:

- Explain the importance of creating and discussing the vision statement
- Determine the documents necessary for managing risks
- Describe company culture and the purpose of a code of conduct
- Summarize how to outline and schedule the operational steps of the launch

The big day has arrived. Your opportunity recognition process noted that your idea solves a significant problem or need, you double-checked that the target market is large enough for potential profitability, you have a method to reach this target market, you have a passion to start this company, and you found resources to support the start-up. Knowing that you analyzed and addressed these topics, you now need to consider some of the more sensitive topics regarding the agreements within your team. Many entrepreneurs overlook the issues discussed here or act on them in a generic manner instead of fitting them to the specific needs of the venture. This lack of due diligence can be detrimental to the success of the business. The advice presented here can help you avoid those same mistakes.

To protect the interests of all parties involved at launch, the team should develop several important documents, such as a founders' agreement, nondisclosure and noncompete forms, and a code of conduct. Before these are drafted, the team should ensure the venture's vision statement is agreed upon. (See Entrepreneurial Vision and Goals for a discussion around creating a vision statement.) The entrepreneurship team needs to be in complete agreement on the vision of the venture before they can successfully create the founders' agreement. If some team members have an interest in creating a **lifestyle business** (a venture that provides an income that replaces other types of employment), while other team members want to harvest the venture with significant returns, there is a clash between these expectations. An angel investor will also have a strong opinion on the vision for the venture.

Founder's Agreement, Nondisclosure Agreement, and Noncompete Agreement

Honest and open discussions between the entrepreneurial team members, including your angel investor if an angel investor is part of your initial funding, must take place before opening the venture. These frank discussions need to include a founders' agreement as well as the identified vision for the venture. The **founders' agreement** should describe how individual contributions are valued and fit into the compensation plan and should consider and answer these questions:

- Will the entrepreneurial team members receive a monthly compensation?
- Is there a vesting plan with defined timelines aligned with equity percentages?
- What happens if a team member decides to leave the venture before an exit event? How will that team member be compensated, if at all?

Discussing the entrepreneurial team members' expectations avoids the problem of an entrepreneurial team member expecting a large equity stake in the company for a short-term commitment to the venture, and other misguided expectations. Such problems can be avoided by addressing the following questions:

- What activities and responsibilities are expected from each team member, and what is the process or action when individual overstep their authority?
- Is there an evaluation period during which the team members discuss each other's performance? If so, how is that discussion managed, and is there a formal process?
- What happens if a team member fails to deliver on expected actions, or if an unexpected life event occurs?

The founders' agreement should also outline contingency plans if the business does not continue. The following questions help define those next steps and need to be answered prior to opening the venture:

- If the venture is unsuccessful, how will the dissolution of the venture be conducted?
- What happens to the assets, and how are the liabilities paid?
- How is the decision made to liquidate the venture?
- What happens to the originally identified opportunity? Does a team member have access to that idea, but with a different team, or implemented using a different business model?

Once the venture opens, discussing these topics becomes more complicated because the entrepreneurial team is immersed in various start-up activities, and new information affects their thoughts on these issues. Along with these topics, the founders' agreement should also state the legal form of ownership, division of ownership (this refers to the division of equity at either the next round of financing, or harvesting of the company), as well as the buyout, or buyback clause. (See Entrepreneurial Journey and Pathways for a discussion on the life cycle stages of a venture, including end stages of harvesting, transition, and reincarnation of the business.)

The **buyback clause** addresses the situations in which a team member exits the venture prior to the next financing round or harvesting due to internal disputes with team members, illness, death, or other circumstances, clearly stating compensation and profit distribution (with consideration of what is reinvested into the venture). Discussing these topics provides agreement between all team members about how to address these types of situations. The buyback clause should also include a dispute resolution process with agreement on how the dispute solution is implemented. Identifying exactly how these items are handled within the founders' agreement prevents future conflicts and even legal disputes.

If the entrepreneurship team includes an angel investor, the angel investor typically has the final say in these questions. In the best possible scenario, the angel investor has experience creating a founders' agreement and can provide valuable insights into working through this document. One common approach to creating this document, given the angel investor's available time, is for the entrepreneurship team to discuss and agree on the final document, then have the angel investor review the document for final approval. Making Difficult Business Decisions in Response to Challenges will help in finalizing your founders' agreement.

After completing the formal vision statement and the founders' agreement, you might want to have an attorney evaluate the documents. This checkpoint can identify gaps or decisions that were not stated clearly. After receiving the examined documents back, the team should once again review the documents for agreement. If everyone is satisfied with the documents, each entrepreneurship team member should sign the document and receive a copy. If, later, the entrepreneurship team decides a change needs to be made to either the vision statement or the founders' agreement, an addendum can be created, again with all parties agreeing to any changes.

Two other formal documents your team might want to consider include a nondisclosure agreement and a noncompete agreement. These documents can be applied to all employees, including the startup team, with consideration of extending to other contributors such as contractual personnel. A **nondisclosure agreement** agrees to refrain from disclosing information about the venture. Topics that might be included in this document include trade secrets, key accounts, or any other information of high value to the venture or potentially useful to a competitor. A **noncompete agreement** states that the person signing the agreement will not work for a competing organization while working for the venture, and generally for a set length of time after leaving the venture. Often, this time period is one year, but it can be longer depending on the know-how or intellectual property the exiting team member has.

Company Culture and Code of Conduct

In conjunction with these formal documents, the founding team should determine the culture they would like to build for their venture. Ideally, the organization's **company culture** is made up of the behaviors and beliefs that support the success of the organization. For example, when you walk into a business, is there a bustle of noise and activity, or is the business calm and restrained? This impression results from the organization's culture. We could compare the difference between walking into a high-end jewelry store and walking into a fast food restaurant. Both businesses have distinctly different cultures. If the venture is highly dynamic with fast-paced decisions and constant change, then the culture should support this type of venture. Perhaps the team wants to create a work hard, play hard culture. In that case, standards that support ad hoc team creation for impromptu discussions should be encouraged, rather than setting up a bureaucratic culture that requires approval of all meetings and deliberation of decisions prior to action. Many tech companies support a work hard, play hard culture. This culture is reinforced with open office spaces that provide opportunities to collaborate with colleagues. Or perhaps ping pong tables and kitchens are provided to encourage interaction. Even the hours of operation contribute to culture creation by either encouraging employees to set their own hours or restricting work hours through regulated entry. In contrast, a more bureaucratically structured environment may fit a venture whose success relies upon compliance with external regulations and the use of highly sensitive or private information. An example of a bureaucratic culture aligns with many financial institutions. The culture within a bank conveys security of our deposited funds; we want a bank to have processes and systems in place that reinforce that we can trust the bank with our finances.

The culture-defining process should include the entrepreneurship team's creation of a **code of conduct**. Some organizations develop a code of conduct that includes guiding principles, while other organizations create detailed descriptions of what is acceptable and what isn't acceptable. Your venture's code of conduct should fit with your venture's vision, the culture desired, and the entrepreneurship team's values. Codes of conduct should be created as documents that include a sensitivity to people within the company as well as the greater community. A code of conduct addresses the values that the organization supports, as well as ethical considerations. The purpose of a code of conduct is to help guide employee actions to align with the desired behavior. Including uniquely specific examples that align with the specific venture, can further communicate the desired behaviors. There are many varieties of codes of conduct; the main point is to create a code that supports the values and behaviors that you want to advance throughout your organization. Figure 15.2 and Figure 15.3 show two approaches to developing a code of conduct that fits the company's culture and vision. The first example might be used by an advocacy-based venture that desires a principle-based approach to guiding employee behaviors through a code of conduct that provides general guidelines, rather than a more rule-based approach as presented in the second example. These two examples highlight the importance of creating a code of conduct that fits the beliefs and culture that you want to encourage within your venture.

CODE OF CONDUCT
For Peaceful Direct Action

I will...

- Treat each person (including workers, police, and media) with respect
- Connect with people and attempt to win hearts and minds
- Not use violence, threats, or insulting language
- Protect opponents from insults or attack
- Not damage equipment, apparatus, or property of others
- Accept responsibility for my actions
- Behave in an exemplary manner if I am arrested
- Assert my right to protest
- Know the limits of my anger or despair and develop strategies to manage and channel these emotions constructively

Figure 15.2 This sample code of conduct demonstrates how a code of conduct needs to fit the specific organization's needs. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

CODE OF CONDUCT	
Compliance with All Laws	Employees must comply with all laws, including bribery, fraud, securities, environmental, safety, and employment laws.
Corruption and Fraud	Employees must not accept certain types of gifts and hospitality from clients, vendors, or partners. Bribery is prohibited in all circumstances.
Conflict of Interest	Employees must disclose and/or avoid any personal, financial, or other interests that might influence their ability to perform their job duties.
Company Property	Employees must treat the Company's property with respect and care, not misuse it, and protect company facilities and other material property.
Cybersecurity and Digital Devices Policy	Employees must not use company devices or company-provided online access to download or upload obscene, offensive, or illegal material; to transmit confidential information to unauthorized recipients; to pirate movies, music, or software; or to visit potentially dangerous websites that can compromise the network and computers' safety.
Social Media Policy	Employees may [or may not] access personal social media accounts at work but are expected to act responsibly, follow company policies, and maintain productivity.
Sexual Harassment	Employees must not engage in unwelcome or unwanted sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature. Behaviors such as conditioning promotions, awards, training, or other job benefits upon acceptance of unwelcome actions of a sexual nature are always wrong.
Workplace Respect	Employees must show respect for their colleagues at every level. Neither inappropriate nor illegal behavior will be tolerated.

Figure 15.3 This code of conduct addresses more traditional and general topics than in the first example. In all cases, the code of conduct needs to address your unique venture including awareness of how the code of conduct aligns with the leadership and culture that you want to develop.[1] (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Earlier, we discussed the importance of the lead entrepreneur taking the initiative to discover the investor's

1 Some language adapted from the U.S. Department of State Sexual Harassment Policy: https://www.state.gov/s/ocr/c14800.htm.

business knowledge and learning about the investor's previous experience in funding an entrepreneurial venture. The code of conduct is another area that entrepreneurial teams frequently skip over by accepting a generic code of conduct rather than recognizing that there are a multitude of topics, phrases, and principles that should be uniquely designed to fit the venture. These two examples demonstrate the vastly different topics addressed within a code of conduct as evidence for why your code of conduct must fit your intentions for how you will conduct business and support the success of your venture.

These preparatory documents should be personalized to align with the entrepreneurial team and desired behaviors that support the success of the venture. Although standard language and forms addressing these topics are available online, these generic models aren't intended to meet your unique venture's needs or the entrepreneurial team's needs. Taking the time to discuss and prepare these documents pays off in well-crafted documents and aligns the entrepreneurship teams' vison, goals, and dreams for their venture.

ARE YOU READY?

Google's code of conduct

Review Google's code of conduct (https://openstax.org/l/52CodeConduct) as you think about developing your own code of conduct. What do you like about Google's code of conduct? What would you change? How does this example help you in creating a code of conduct for your venture?

Operational Steps to Launch

The next action is outlining the operational steps in the venture creation process. A good approach is to create a chart that identifies how you should proceed. The goal in creating this chart is to recognize what actions need to be taken first. For example, if you need a convection oven for your business, what is the timeline between ordering and receiving the oven? If you need ten employees to manually prepare and package your product, how long will it take to interview and hire each person? According to Glassdoor, the hiring process took 23 days in 2014 and appears to be lengthening in time as organizations become more aware of the importance of hiring the right person.[2] What about training? Will your employees need training on your product or processes before starting the venture? These necessary outcomes need to be identified and then tracked backwards from the desired start date to include the preparatory actions that support the success of the business. You've probably heard the phrase that timing is everything. Not only do entrepreneurs need to be concerned about finding the right time to start the venture, they also need the right timing to orchestrate the start-up of the venture.

Below is a sample **Gantt chart**, a method to track a list of tasks or activities aligned with time intervals. You can use this tool to help identify and schedule the operational steps that need to be completed to launch the venture. One approach to creating a Gantt chart is for each team member to independently create a list of operational activities or tasks required to start the venture that fall under their area of involvement. Then the team can create a master list of activities to discuss: This helps clarify who is contributing to or owning each task. Next, have all team members create their own Gantt chart based on their task list: That is, the time required for each task should be spelled out, including steps that must happen sequentially (when one task

2 Glassdoor Team. "How Long Should the Interview Process Take?" June 18, 2015. https://www.glassdoor.com/blog/long-interview-process/

cannot be started until another step is complete). Once again, bring all team members together to create one master Gantt chart. This will help ensure that dependencies from member to member are accounted for in the planning. These contingencies and dependencies need to be identified and accommodated for in the master schedule. For example, in Figure 15.4, we see that Mike Smith cannot perform system testing until Sam Watson has developed the system modules, and in turn, that task can't be done until Mike Smith has documented the current systems. After completing the chart, agree on assignments of responsibility to follow through on the activities, based on the timelines from the Gantt chart.

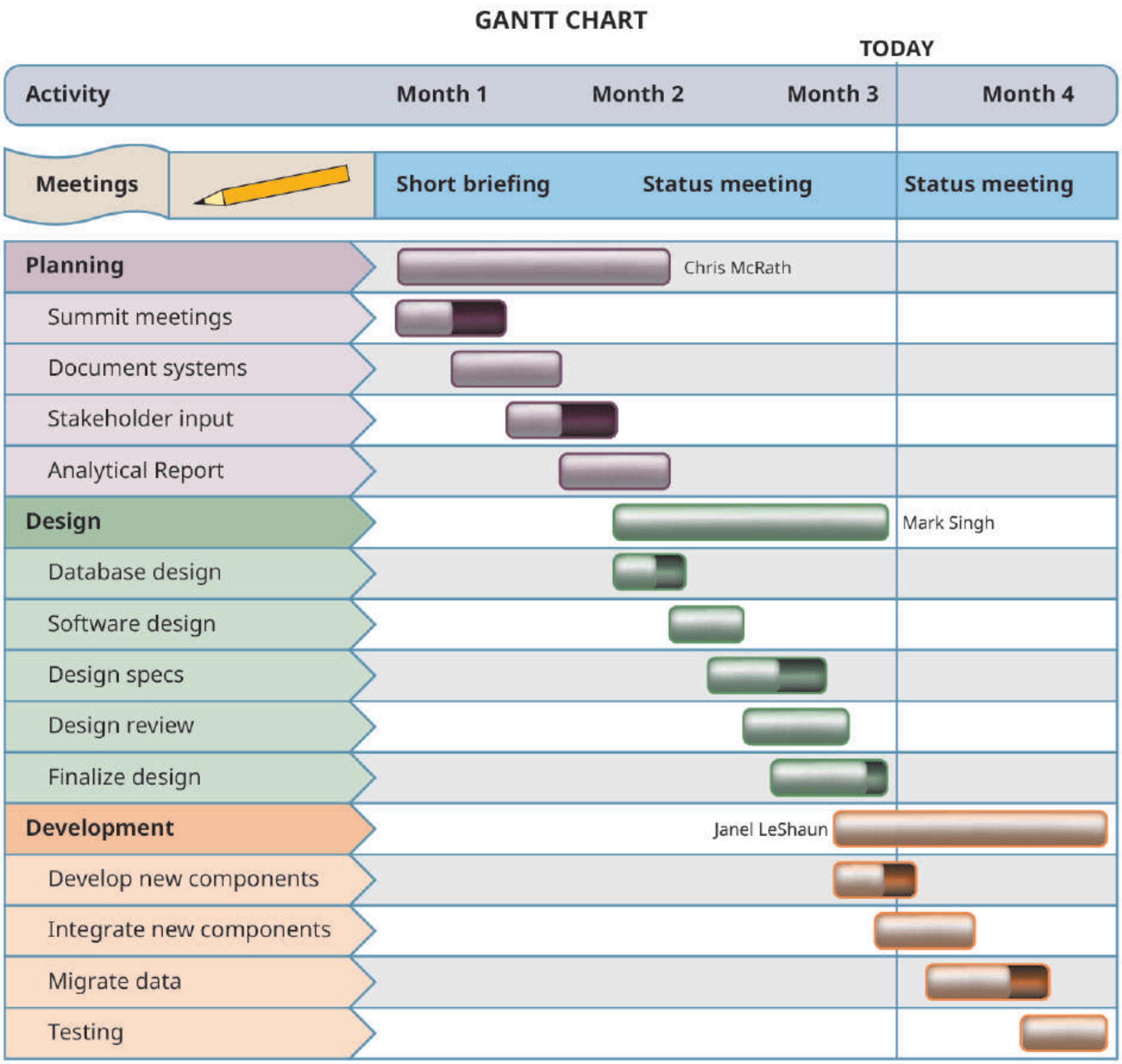


Figure 15.4 This sample Gantt chart demonstrates how activities are listed and tracked over time to assist in organizing and planning a sequence of activities. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

See the Suggested Resources for more information on how to use a Gantt chart to assist in tracking the actions needed to support the start-up of your venture and to organize each action based on your necessary timelines. You might want to reach out to other sources to find examples of how other entrepreneurs worked through their operational start-up steps.

LINK TO LEARNING

This TED Talk features Paul Tasner (https://openstax.org/l/52PTasnerTED) sharing how he found himself changing his career at the age of 66, reinforcing the idea that the world of entrepreneurship is open to all people regardless of age, race, background, health, or geographic location. In this presentation, he references a variety of activities he needed to experience in order to understand the process of starting his venture. Regardless of what we learned in our past experiences, launching a new venture includes new experiences and decisions.

After watching this video, do you have some ideas regarding starting a new venture around the idea of senior entrepreneurs? How could you support this group or build a network that creates a community of support for this large population?

Launch Considerations

Sage advice in launching the new venture is to quickly recognize when you don’t have the answer or information to make the best decisions. In the early stage of launching the venture, the level of uncertainty is high, as is the need for agility and spontaneity. Even identifying the actual moment when the venture becomes a new venture can be difficult to determine. Should the venture be recognized as a new venture after receiving the necessary licenses or tax identification number, or when the first sale occurs, or when funds are first invested, or by some other method?

It is also important to keep in mind the end goal of the venture, often referred to as "begin with the end in mind." For example, many highly successful ventures never earn a dollar in sales. Depending on the entrepreneurial team’s vision and the business model selected, the venture could be highly valuable from a harvest, or sale of the venture, perspective. Frequently, this decision is dictated by the angel investor. These people frequently started their own venture, harvested the venture, and as a result have funds available to invest in other new ventures. In most cases, the angel investor expects to cash out of the venture at some point in the future. These are investors who are not interested in holding a long-term equity position but rather expect to grow the venture into a position where another company buys out the venture. This buyout is also known as the harvesting of the venture and the point at which the angel investor receives a percentage of the harvested dollar sale to cover the equity stake in the new venture. Because of this pattern, entrepreneurs are often advised to “begin with the end in mind” when launching a new venture. If the goal is to sell the venture to another company, we want to identify that company before launching the venture. Of course, at this point, this is only a desire or hope, as you cannot require or expect another company to have an interest in your new venture. But you can design the new venture to align with this end goal by making decisions that support this end goal.

Consider the example of YouTube, a startup with zero dollars in sales but with a harvest price of $1.65 billion in stock from Google. The startup team, former PayPal colleagues, understood that the technology was being developed for video searching and recognized that creating a platform to house video-sharing would be desired by companies such as Google at some point in the future. Consider the tight timeline between 2005 when YouTube began supporting video sharing, and the harvest of YouTube to Google in 2006, 21 months later. This example clearly points to the importance of beginning with the end in mind.

ENTREPRENEUR IN ACTION

A New Greeting Card Concept

Is there a connection between ship architecture and greeting cards? Most people would quickly say there isn't any connection between these two disparate ideas. However, Wombi Rose and John Wise studied ship architecture, with Wise moving on to a boat-building start-up in Louisiana when they reconnected and decided to start a new venture. While traveling in Vietnam, the two ship architects came across the paper-cutting process of kirigami, similar to origami, but rather than folding paper, the paper is cut. The two engineers realized that the same design software used in building ships could also be used in creating these three-dimensional paper objects. Despite the declining greeting card industry's sales, these two entrepreneurs decided to enter the greeting card industry with a new approach to greeting cards. Pop-up kirigami art folds flat until the envelope opens, and a kirigami object pops up. Lovepop, the name of their greeting card line, has grown to 30 employees and $6.7 million in revenue.[3]

What evidence is there that Rose and Wise followed the concept of "begin with the end in mind"? If Rose and Wise followed this advice, and you were a part of this team, at what point would you begin seeking a buyer for this company? What milestones might you select for harvesting the company? Consider what actions you would accomplish to increase the sale amount to the maximum amount.

Launching your venture is a unique experience for every entrepreneurial team and for every venture. These novel situations and uncertainties create both challenges and new learning opportunities. Accepting that a multitude of possibilities exists and recognizing the importance of researching and discussing actions are valuable to the success of the team. Angel investors hold a wealth of knowledge, and with an equity stake in the venture, these investors should be included in all discussions. If you have an angel investor on your team, you have an added advantage to tap into the expertise available to support the venture. In conjunction with a well-aligned angel investor, conducting research to explore decisions will improve your venture's success. Although these decisions might seem difficult, the next section addresses how to approach difficult decisions and the role emotional connections for the venture and its team play in those decisions.

15.2 Making Difficult Business Decisions in Response to Challenges

Learning Objectives

By the end of this section, you will be able to:

- Recognize that cognitive biases can sabotage the success of the venture
- Identify key problem indicators
- Distinguish the emotional components involved in difficult decisions

Now that you are prepared to launch your business venture, let's look at your business plan and the assumptions you made while preparing it. Did you keep a list of assumptions? Did you update assumptions as

3 Stephanie Schomer. "This Hot Greeting Card Company Uses 3-D Design and Origami to Beat Hallmark. *Inc.* June, 2017. https://www.inc.com/magazine/201706/stephanie-schomer/lovepop-greeting-card-design-awards-2017.html

new data and information suggested “retiring” some initial ideas? Did you identify milestone timelines within your business plan? Did you fully assess risks and have mitigation plans to address them? These are essential questions to consider before launch. As the business venture comes into existence, you should review your assumptions and identified milestones. Ask the following questions:

- Are your assumptions still realistic?
- Is your business venture on for the associated milestones?
- Do you need to consider any changes that have occurred in the industry you plan to enter? Has the competition changed? Are there new regulations?

Tracking any changes and comparing them to your earlier assumptions provides an opportunity to reconsider whether changes to your plan, assumptions, and milestones are necessary. After you begin your venture, you should continue to review your assumptions and milestones. If you are not meeting your projections and milestones, what has changed? What decisions should you adjust to situate your venture into a stronger position for success? If your venture is doing better than expected, analyze why the venture is exceeding your forecasted projections.

It is important to return to your business plan and consider what you will do if your assumptions are incorrect, so if your milestones aren’t met, you can avoid the problem of escalation of commitment. The concept of **escalation of commitment** describes when an entrepreneur feels so committed to the plan of action that they end up losing their perspective on the reality of what is happening to the venture. They ignore the danger signs and think that if they just work harder, or pour more money into the venture, they can force the venture to become successful. Once an entrepreneur becomes this committed to the venture and is working passionately to keep the enterprise afloat, they can lose the focus and objectivity to make rational decisions. They can begin to react to the situation, stubbornly persist, or begin to ignore the danger signs that should alert them that reevaluation of the situation is necessary.

Escalation of commitment negates the recognition that a pivot action is necessary. As you recall from Launch for Growth to Success, in the entrepreneurial world, pivot is the action in response to recognition that the current method, approach, process, or idea isn’t working. Pivot is the point at which entrepreneurs realize that a change is required and pivot into something different.

Cognitive Biases and Problem Indicators

There is a fine line between believing in one’s abilities and the value of the venture versus stepping into a perspective that ignores new information or results. Entrepreneurs often need to face criticism and challenges where their confidence in the opportunity and their ability to create a successful venture override the criticism, but there is also danger in not listening to new information and re-evaluating one’s perspective to avoid biases. According to Cossette, in reviewing twenty-five empirical papers on heuristics and cognitive biases of entrepreneurs, overconfidence and optimism are the two most significant biases that contribute to an entrepreneur’s failure to recognize the need to change or end the venture. Other causes for the entrepreneur’s failure to end the venture include “the law of small numbers, the illusion of control, the planning fallacy, escalation of commitment, the status quo bias, and the hindsight bias,”[4] as shown in Figure 15.5. To avoid this failure to exit the venture, we can identify **fail-safe points** within the business plan. These are the points that trigger the entrepreneur to consider what actions are needed to bring the venture back to a healthy position and whether this action is reasonable and feasible. Identifying these trigger points

4 Pierre Cossette. “Heuristics and Cognitive Biases in Entrepreneurs: A Review of the Research.” *Journal of Small Business & Entrepreneurship*, *27*(5), 471–96. November 2015. doi:10.1080/08276331.2015.1105732

and creating contingency plans *before* opening the venture can prevent the entrepreneur from becoming trapped by these biases, such as the dangers of becoming overly committed and throwing resources into an impossible situation. Let’s look deeper into these biases and potential key problems that challenge our own decisions and the success of the venture.

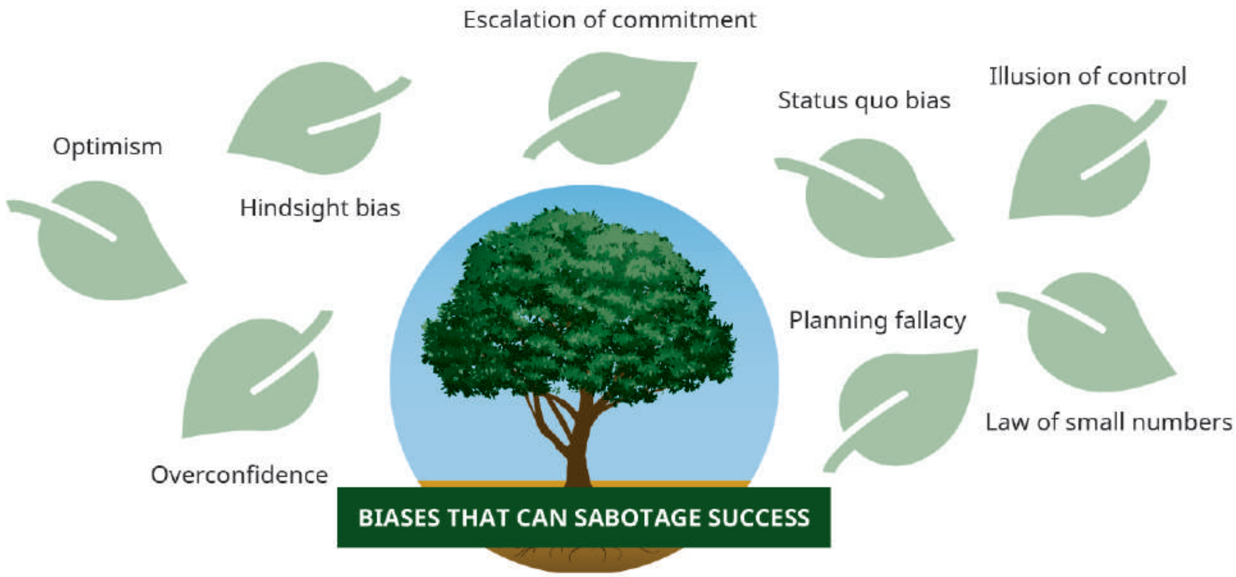


Figure 15.5 The biases shown in this image are areas that can contribute to the failure of the venture. Being aware of these biases provides a reality checkpoint. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

As described in Cossette’s research, the *law of small numbers* refers to the target market not being large enough, or failure to attract a larger target market. The *illusion of control* refers to the entrepreneur believing that he or she can force the market into realizing the venture is the best, or that additional persistence will result in positive results. The **planning fallacy** identifies the pattern of creating a business plan that is too optimistic. Gish noted that business planning is intended to present realistic decisions and projections; however, research suggests that confidence in the plan places entrepreneurs in a position of believing their plans are accurate, causing a heightened belief that the venture will succeed, when in fact, the business plan is overly optimistic.[5]

The **status quo bias** is a tendency to refer to a previously identified behavior or information as the ongoing habit to perpetuate. This bias can prevent the entrepreneur from recognizing that a new action is required—when a creative or innovative change is necessary to avoid economic distress rather than following a previously established pattern or habit—instead of continuing to follow the status quo. The **hindsight bias** is the belief that, in hindsight, the action or event was predictable, when in fact there was little if any indication that an event would occur.

As you can see, many of these problems are related to the **hubris** of the entrepreneur. Hubris is a strong belief in oneself, a belief of over-confidence or pride in one’s ability to affect the outcome of decisions when other factors have the greatest influence.

5 J. Jeffrey Gish. “Failing to Plan but Not Planning to Fail: A Theory of Entrepreneur Optimism and Business Planning.” *Academy of Management Annual Meeting Proceedings*, *2016*(1), 1. November 30, 2017. doi:10.5465/AMBPP.2016.10945abstract

Aside from these challenges, other key problem indicators include insufficient available cash. **Burn rate** is the rate at which the venture burns through the available cash needed to sustain the business: More cash is going out than is coming into the business (review burn rate in Developing Startup Financial Statements and Projections). Lack of control systems can be a contributor to excessive cash use, as can excessive waste in production, lack of follow through on collection of payment, or low inventory turnover creating excessive waste, such as with perishable products.

A misconnect between the target market's desires and the product or service provided, can also create challenges, as can incorrect pricing of the product, or not having the right talent in your personnel or start-up team. However, planning only for success can be the biggest problem an entrepreneur makes. Keeping an open mind provides opportunities to see the reality of how the venture deviates from the plan as an action item to reconsider the venture from a new perspective.

Decision Making to Overcome Challenges

Now let's look at how we can reevaluate the venture and consider what changes are possible to position the venture for a different future than first envisioned. Let's examine a real story from Stacy Madison's life. Stacy Madison is the entrepreneur who started Stacy's Pita Chips. Madison had a background in social work but wasn't happy with her career choice, so she decided to open a sandwich food cart business in downtown Boston. As her business became more popular, customers had to wait in line for longer times. When they reached the food cart window, they were often cranky and unhappy about the wait. Madison and her team discussed ideas on what to do for customers who grew tired of waiting in line. They came up with the idea of slicing bagels into chip size bites and baking the bagels with olive oil, then handing the bagel chips out to the customers waiting in line. Customers loved the bagel chips and requested the chips when they reached the food cart window. At first, Madison's team would explain that they did not sell the chips but only gave them away to help their customers who grew hungry waiting in line. After repeatedly hearing this request from customers, Madison reevaluated her sandwich business and considered that maybe she should be in the bagel chip industry. The success of this story is that Madison sold her pita chip company to Frito-Lay for $65 million.[6] And the purpose of this example is to remember that when we start a venture, we need to be open-minded to recognize unexpected patterns and new information that can lead us in a different direction from the original plan and intention.

Personnel Change Challenges

One area of potential problems in a new venture is the entrepreneurial team, the start-up people on the original team, and the need for personnel changes within the team. Where did the people on your startup team come from? Are some of them longtime friends or perhaps family members? What skills or knowledge do they bring to the venture? Are they aligned with the needs of the venture? And importantly, are they the best resource for their role once the venture is up and running? Answering these questions clarifies whether team members are a good fit within the venture over time. The startup team no doubt provided enthusiasm and ideas that helped to identify and formulate the potential new venture. Team members probably contributed ideas and content in building the business plan, but over time, the needs of the venture will change. Being aware that changing needs might also result in changes within the startup team, and employee

6 Katie Morell. "The Story behind Stacy's Pita Chips." Open Forum. May 11, 2012. https://www.americanexpress.com/us/small-business/openforum/articles/the-story-behind-stacys-pita-chips/

skills, is part of managing the growing venture.

For success, the team and employees need to align with the needs of the venture. Sometimes, entrepreneurs begin their business with people who agreed that the idea was sound and that the opportunity existed and was worth supporting. But these people might not have the knowledge, skills, and abilities necessary to support the venture as it grows. Frequently, we share similar skills and interests with our friends and family members. This means that we might have a venture with too many people with the same skill sets. Or we might have disconnects between what the venture needed in the past and what the venture needs currently.

Another personnel problem is discovering unethical actions that violate the code of conduct created in the preparatory documents. According to the National Business Ethics Survey of the U.S. Workforce in their 2014 report, 60 percent of reported misconduct involved someone with managerial authority.[7] These findings alert us to the importance of creating a code of conduct that aligns with the values needed to support the success of the organization. When the entrepreneur feels pressure to act unethically in an attempt to bring in new business or prevent the organization from financial stress, unethical actions can become tempting. Knowing that 60 percent of unethical actions occur at the managerial level should provide evidence to support the need to proactively consider how to avoid this dangerous situation. The same report encourages addressing potential problems by including zero tolerance for abusive behavior, lying, discrimination, and sexual harassment. An interesting finding noted that egregious rule-breaking behavior was infrequent, while more subtle “ongoing and continuous behavior, such as abusive and intimidating behavior, seems to be more prevalent.”[8] This result speaks to our earlier discussion on the importance of creating an appropriate culture. If an undesirable behavior is prevalent, this would seem to indicate that the culture supports this behavior. The study also noted that “frequency of misconduct reflects the strength of the company’s ethics culture,” noting that “60% of misconduct committed in companies with a strong ethics culture was a one-time occurrence,” and that frequency of unethical acts rose as the culture of ethics declined.[9]

Recommendations from this same report for encouraging ethical behavior include the actions shown in Figure 15.6.

7 Ethics Resource Center. National Business Ethics Survey of the U.S. Workforce. 2014. https://www.bentley.edu/sites/www.bentley.edu.centers/files/centers/National%20Business%20Ethics%20Survey.pdf
8 Ethics Resource Center. National Business Ethics Survey of the U.S. Workforce. 2014. https://www.bentley.edu/sites/www.bentley.edu.centers/files/centers/National%20Business%20Ethics%20Survey.pdf
9 Ethics Resource Center. National Business Ethics Survey of the U.S. Workforce. 2014. https://www.bentley.edu/sites/www.bentley.edu.centers/files/centers/National%20Business%20Ethics%20Survey.pdf

POLICIES AND PROCESSES THAT ENCOURAGE ETHICAL BEHAVIOR

- Maintain commitment to ethics and compliance programs and seek industry leadership.
- Focus on efforts to empower employees and deepen their commitment to the company and its long-term success.
- Develop ongoing programs and structures to monitor misconduct within the company.
- Develop initiatives to address the most common forms of misconduct.
- Educate workers about Dodd-Frank and other laws designed to encourage whistleblowers and protect them from retaliation.

Source: Ethics and Compliance Initiative. National Business Ethics Survey 2014. http://ethics.org/research/nbes

Figure 15.6 The Ethics and Compliance Initiative from the National Business Ethics Survey outlines policies and processes that encourage ethical behavior. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Ethics and alignment of personnel to the venture's future growth and success are all reasons to reevaluate the entrepreneurial team and personnel. Frank conversations are required to protect the future success of the venture and the best decisions to support this success. Ethical challenges need to be addressed quickly and preferably proactively to avoid being pulled down into reacting to a crisis that could be avoided by creating a culture and code of conduct that encourages correct actions. Sage advice is to clearly state up front the vision for the venture and agreement from the start-up team that the survival of the venture is the priority. Ethical behavior is an important topic of these discussions.

Personnel and Growth Challenges

Before starting the venture, the start-up team should ask these two questions:

1. What happens if we are wildly successful?
2. What happens if we are horribly unsuccessful?

The purpose of these questions is to consider how resources and debts will be resolved before the venture begins to use or acquire resources. If your relative or friend contributed by letting you use her living room for your planning meetings and bought pizza to keep the team energized, does she have a stake in your venture? If your venture is wildly successful, she might believe that she should receive financial remuneration for her contributions. The point is, people often change when there is lots of money or when the venture is on the edge of disaster. Planning for both extremes provides a framework for the entrepreneurial team to consider their own expectations and the expectations of other people involved in the project *before* these types of situations happen.

This discussion should also address the agreed-upon method for making difficult personnel decisions. Is there a severance package? If so, who is entitled to the severance package? Does the exit of employees, and even people on the start-up team, exclude them from future expectations if the venture is successful? If the funding source includes contractual liabilities, how is the release of a start-up team member resolved? If new team members or employees are added, will these people be considered employees who earn wages, or are some positions identified as receiving equity positions with financial gains through the harvesting of the venture?

Addressing these questions before starting the venture can preserve relationships by clearly stating and agreeing to these sensitive decisions that can carry long-term consequences. In considering these questions and awareness of how the venture's need will change in the future, you might want to revisit your founder's agreement for clarity and alignment with any new information or concerns that arise in the start-up phase.

Lack of Sales and Customer-Base Challenges

Perhaps the biggest disappointment is when the entrepreneurial team has completed the pre-planning, received funding, and opened the venture for business, only to find out that sales aren't realized. The target market isn't rushing to the website or location to purchase the product or service.

There are many reasons this can happen, which can make finding a solution difficult. The first action is to bring the team together to discuss possible reasons why the projected sales aren't being realized. This could result from inadequate marketing, targeting the wrong market or audience, selecting the wrong distribution system, communicating the wrong message or benefit within the marketing plan, or perhaps lack of training for sales personnel or first responders who manage the venture-customer relationship.

Identifying the problem is one solution to consider. Some tools that help in problem identification include brainstorming, creating mindmaps, and conducting additional research. Brainstorming provides a free flow of ideas for further exploration and analysis. The most important part of brainstorming is not judging any ideas: the more ideas that are shared, the higher the probability for identifying the problem. A mindmap taps into a different approach to gaining a new perspective on thinking about the problem. A mindmap has a center that states the problem, such as lack of sales. Next, you create branches identifying all the possible reasons why the problem occurred, such as incorrect target market and incorrect marketing message. Then you create sub-branches that relate to these first-level branches. Including pictures and color diagrams contributes to the process. The goal in creating a mindmap is to be creative in *exploring the problem* rather than attempting to hone in on a solution. Adding visuals encourages people's brains to think creatively. After creating the mindmap, take a break from thinking about the problem. As strange as this seems, the process of focusing on creating the mindmap alerts your mind that this is a problem that is important. As you walk away from the problem, your mind is still thinking about the problem, but at a subconscious level. This opens the opportunity for an "aha" moment where you're better able to figure out what is happening and understand what you need to do.

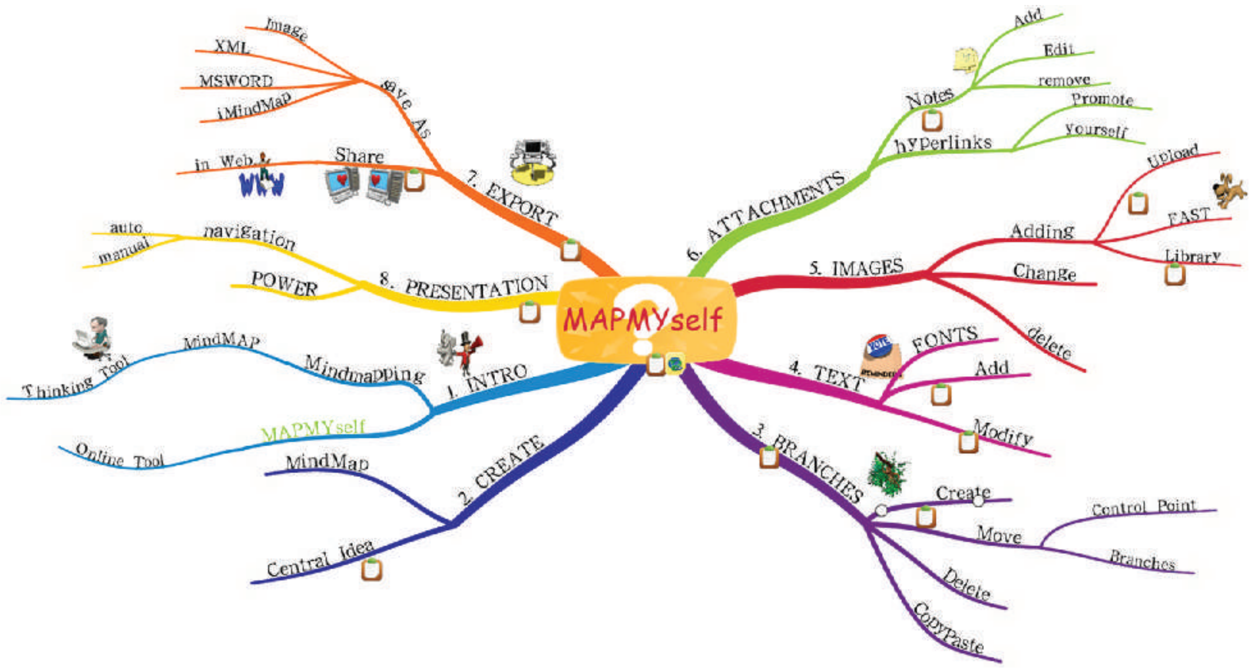


Figure 15.7 Example of a mindmap. Mindmaps can be created to inform and increase creativity in both understanding the topic or problem, and in discovering connections. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

Both brainstorming and mindmapping are excellent tools that lead to conducting more research. After completing brainstorming and mindmapping, you should have a better understanding of the problem and a clear picture of topics to research, and possible methods to gain new insights into the problem of lack of sales or customer base, such as surveys, focus groups, or free samples. You can even go back to brainstorming and creating a mindmap around this newly discovered area identified through the first round of brainstorming or creating a mindmap. Or you might already have feedback that reveals a pivot for moving the venture in a new direction, like Stacy Madison did in discontinuing the food cart and moving into the snack food industry. Another response to lack of sales or customers is to use social networking sites to draw attention to your business. You can offer short-term incentives to encourage your target market to react or provide feedback about your product.

ARE YOU READY?

Mindmapping

Practice either brainstorming or mindmapping by identifying a potential problem your venture might face. Include at least four branches and four sub-branches in your mindmap. After reviewing the completed mindmap, identify at least three methods you could use to research the most significant topic discovered through creating the mindmap. Was this activity beneficial? How might you use this method in the future?

15.3 Seeking Help or Support

Learning Objectives

By the end of this section, you will be able to:

- Identify sources for assistance
- Explain the benefits provided through seeking assistance
- Compare tools to assist in deciding what advice to follow

You've learned about some of the challenges in starting the venture and the types of decisions that the entrepreneurial team must make, as well as the importance of recognizing when you don't know something or that you have encountered a problem. Facing these issues is easier when you recognize that asking for help should be part of the process. Given the wide range of variables involved in starting a new venture, it's just not possible for one entrepreneur to have all the answers. Asking for help is an intelligent decision: It's an action that recognizes the complexity of starting and managing a venture.

Types of Assistance

Fortunately, there are many types of assistance available in the field of entrepreneurship starting with your own network of people. Additionally, there are local, regional, national, and even international groups available to help you navigate the entrepreneurial journey.

Ideally, the entrepreneurial team conducted due diligence in their quest for funding (see Entrepreneurial Finance and Accounting). For those entrepreneurs pursuing financing through angel investors, research on what angel investors contribute to the funded entrepreneur beyond the actual dollars invested highlights the importance of the angel investor's expertise and knowledge as a contributor to the venture's success.[10] While many entrepreneurs focus solely or primarily on receiving funding to start the venture, this study points to the importance in selecting an angel investor with knowledge of the industry, the distribution system, the technology, product, or the target market, as imperative to the success of the venture.

We've discussed the importance of finding an angel investor who has a background and experience in a similar area as your venture. Finding the right angel investor not only results in receiving the needed funding, but also access to this person's knowledge and personal network. Ideally, the angel investor has knowledge related to your industry, your target market, and your supply chain or distribution channel. This background knowledge provides you with key resources that can give your venture expertise that contributes to the venture's success. The angel investor's network also provides opportunities to gain key insights, seek advice, and discuss ideas or solutions that benefit the venture as a network of well-informed and experienced people.

The other primary network is the entrepreneurial team's network. These people include spouses/partners, family members, business associates, colleagues, and friends. These people can provide ideas and knowledge from a variety of perspectives and backgrounds. Connecting and reaching out for help requires both the ability to build relationships and the ability to recognize that seeking help reflects maturity and wisdom. As you tap into your network and seek advice, consider each person from a long-term relationship-building perspective. Consider how you might return the favor at a future time, if asked to help, or provide your expertise back to the people you access for help.

As you work with your network, keep track of the person's name, your conversation, and any commitments

10 Karla Peterson and William Mayfield. "Knowledge Transference in the Angel-Entrepreneur Relationship." *Frontiers of Entrepreneurship Research*: 27(2), Article 5.

made during the meeting. A commitment might be a follow-up message on how you used the advice or response to the request, or an action that you will perform for someone else. Creating a formal network or contact system helps in developing this network into a long-term relationship-based perspective.

When seeking advice, be respectful of the other person’s time. This means identifying exactly what type of help you want to request from the person. Are you requesting an introduction to someone else within that person’s network, or advice about solving a problem, or access to physical resources? Setting up an appointment demonstrates respect, as does preparing for the meeting and explaining how you will use the advice. Remember to thank the person and follow up with feedback on what happened from using the advice.

The types of assistance that can be provided through networking include:

- advice or information
- access to other people’s networks
- access to financial resources
- business services such as legal, accounting, or administrative support
- physical resources such as land, buildings, or equipment.

Other free sources of support are instructors of your business courses, other business owners, organizations such as the SCORE (originally called the Service Corps of Retired Executives) and resources within the Small Business Administration (SBA). SCORE is an organization with a network of volunteers across the U.S. and is a resource partner with the SBA. SCORE offers mentor consultants, workshops, and other assistance to support the success of small businesses.

The SBA is a federally funded organization charged with assisting small businesses from startup through their continued existence. The SBA can help in reviewing and improving your business plan, providing assistance in finding funding through loans or grants, and acting as a consultant throughout the venture’s existence. The SBA provides help in complying with both state and federal regulations. Depending on your business model, you might need licenses or permits, and your local SBA office will be well informed on these topics and can help you acquire what is needed to support the success of your venture.

LINK TO LEARNING

Watch this video explaining various services offered by the Small Business Administration (https://openstaxcollege.org/l/52SBAServices) to learn about resources to support your venture.

Most states provide start-up help to small businesses, which can be found by searching the internet for your state’s sponsored help in starting a business. In addition, there are often local meet-up groups and community-supported assistance to help you start your business. You might also find a virtual support group that provides advice from a diverse group of potential business owners.

A paid source of help—legal assistance—can save anguish, time, and money for the entrepreneurial team. In selecting an attorney, look for one with experience in entrepreneurial ventures similar to yours. Resources to help you find an attorney include checking with your network or angel investor for a recommendation or contacting the local branch of the American Bar Association. Most states have an online directory of local member attorneys that you can use to search for a lawyer who fits your venture’s needs. Once you have identified an attorney, research the best method for payment of these services. Some possibilities include a monthly retainer fee, payment for specific services, or payment on an hourly basis for work performed.

Other paid-for services include accounting, tax reporting, and human resource management areas. Opening and managing a business takes time, and assigning a professional accountant the responsibility of preparing monthly financial statements and tax reports can provide you with expert support as well as provide you with time necessary to position your venture into a successful growing business, as does outsourcing personnel tasks such as processing payroll. These supporting companies can be either virtual companies, or a local business, depending on your needs. Especially for payroll and other human resource activities, virtual companies specialize in meeting the administrative needs in a fast and efficient manner. Oftentimes outsourcing administrative areas is a more accurate and cost-effective than completing these tasks within the venture. Although these services cost money, these activities performed require knowledge of laws and regulations that many business owners are not equipped to be experts in, nor can they reasonably stay on top of frequent changes in these matters. This can result in legal problems, as federal and state laws and regulations must be followed.

Support System Development

You learned about a variety of support systems in Building Networks and Foundations. Some entrepreneurs may seek to work with a local incubator service. These incubator community groups provide a physical location to offer working space as well as the opportunity for interactions with other new startup owners and teams. The opportunity to be in a shared space with other inspired entrepreneurs can create excitement, sharing of ideas, and opportunities to talk through challenges. Potentially, there could be synergies between your venture and another venture realized through these discussions.

Companies like Y Combinator in Silicon Valley and Techstars in Boulder, Colorado, provide unique assistance to new startup ventures (Figure 15.8). These types of organizations are considered accelerator entities intended to fast track a select number of new ventures through information sharing, seed funding with a small equity stake in the funded venture, mentoring, and offering formal angel investor “pitch” events. The selection process makes being accepted into these organizations difficult. However, once accepted, your venture becomes more credible for having been accepted, as well as for the wealth of connections and information that will be received throughout the experience.

Figure 15.8 Y Combinator provides support for new startup companies. (credit: modification of “Max Levchin speaks to Startup School” by Robert Scoble/Flickr, CC BY 2.0)

Although each incubation program offers different—and sometimes uniquely specialized—help, they can be generally categorized by the types of support potentially available through these programs. Some incubators focus on one segment of an industry, or one segment of talent or interest. For example, there might be an incubator intended only for marketing start-ups. In this example, the incubator might assist with providing support in various marketing areas such as digital marketing, business-to-business marketing, global marketing, sports marketing, video creation, or other areas that fit within the topic of marketing. Oftentimes, incubators are sponsored by a municipality or government source.

Incubators are unique to a community’s interests and available resources. Some communities have a vision for the community and desire the growth of the community to align with this vision. If a community has this perspective, their incubators would also align with this vision. Other communities create incubators around available resources, such as access and support from specific groups. Figure 15.9 illustrates the wide variety of approaches used in creating incubators. An incubator is supported by perhaps one or two of these sources, depending on the goal of the incubator.

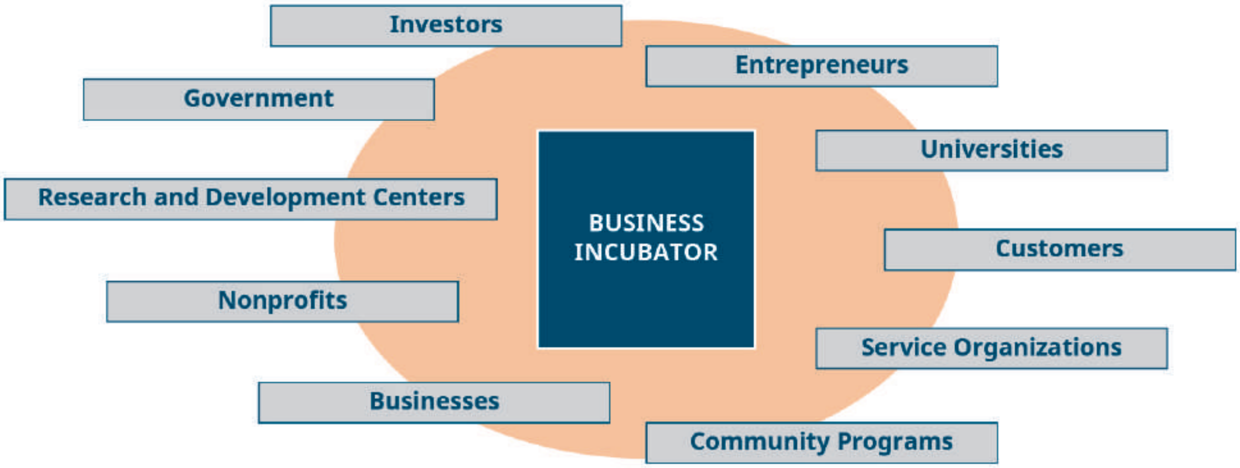


Figure 15.9 There are many potential contributors to business incubation programs. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

As you build your support group, you might want to create an advisory group, which is a formal group of people who provide you with advice. In building your advisory group, select people who demonstrate an interest in your venture and your startup team. You want resources who have expertise related to your industry, your target market, or your business model. You also want a diverse group of people who can provide insights that reflect different backgrounds and knowledge. This diversity of experience and knowledge provides you with the greatest breadth of advice, which leads to your difficult decision: what advice to follow.

Deciding What Advice to Follow

Once you have advice from a variety of sources, how do you decide which recommendations to pursue, which to consider, and which to rule out? One approach is to identify what information is qualitative versus quantitative, and evaluate one type first. Qualitative information is conceptual—about ideas—whereas quantitative information is statistical or numerical. In both qualitative and quantitative areas, the entrepreneur can create visualizations to clarify the information and support analysis and decision making. The brainstorming and mindmaps discussed earlier, and illustrated in Figure 15.10, highlight the different types of data you can work with.

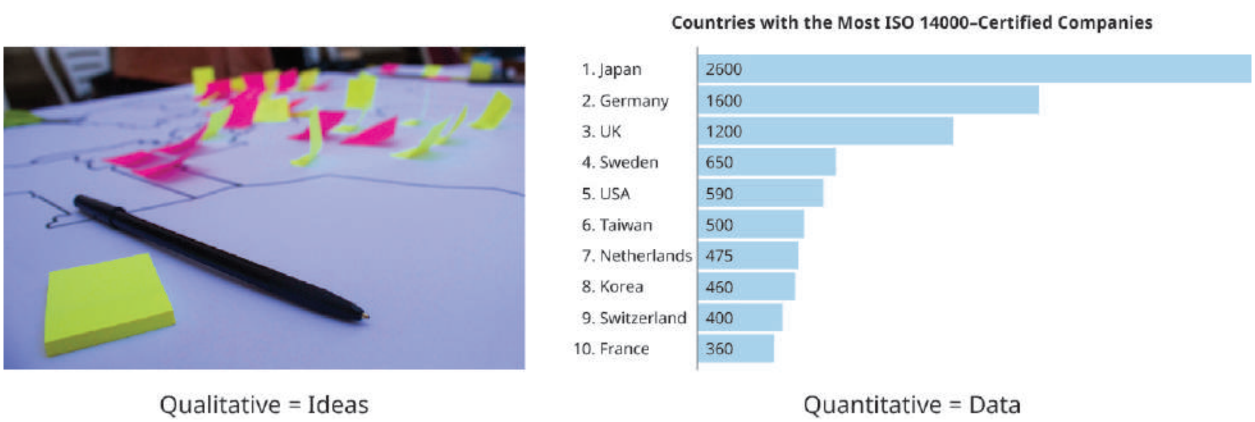


Figure 15.10 Both qualitative and quantitative factors inform decisions through ideas and numbers. (credit "left": modification of "Articulamos nuestras ideas" by Cultura de Red/Flickr, CC BY 2.0; attribution "right": Copyright Rice University, OpenStax, under CC BY 4.0 license)

Two other tools for sorting through advice are the Delphi method and the Nominal Group technique. Both provide a structured methodology that can be applied to evaluate ideas. In the **Delphi method**, broad open-ended questions related to the decision being addressed are put into a questionnaire sent out to participants. For example, you might solicit input from your advisory group or another group closely connected to the topic. As responses come in, the questions are updated to align better with the first set of responses. The process repeats until there is a clear understanding of the participants' responses. Next, you create a list of possible options and request each participant to rank the options. Depending on these results, you either fine tune the list by dropping off low-ranked items, or, if the results are satisfactory, the options are narrowed to two or three top choices.

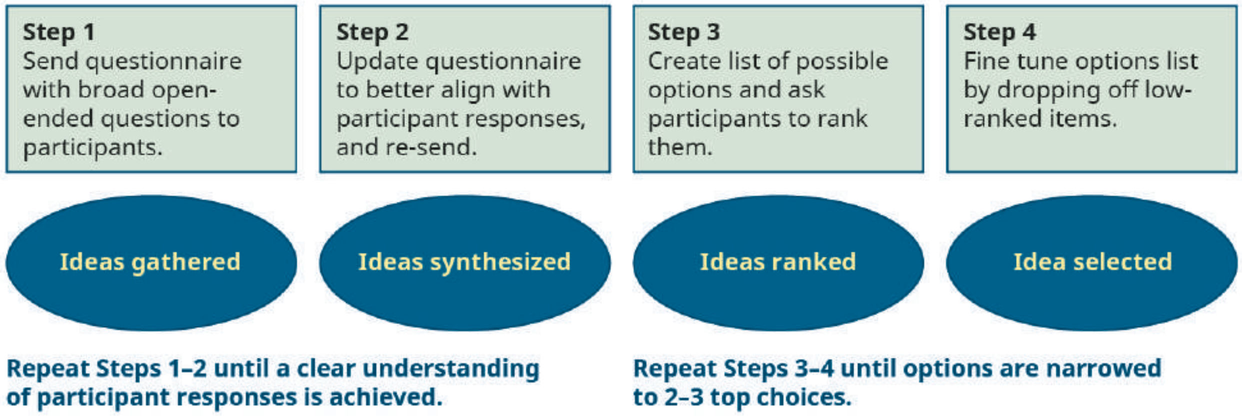


Figure 15.11 The Delphi process proceeds through repetitions of the process until an agreed-upon final answer is identified. (attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license)

The **Nominal Group** technique occurs in a group setting. Participants are presented with a question or topic and write their thoughts in response on a card. The participants do not share their comments. Once everyone has submitted the cards, the facilitator shares all feedback so that everyone can see all participants' input. The participants discuss all of the ideas. Next, the participants again write down their responses on a new set of cards. The comments are again recorded and shared so that everyone can see the results. The process continues until there is agreement on a final filtered, or narrowed, list or set of options. At this point, the participants vote or rank the remaining set of options with the goal of accepting one option.

Although these techniques and tools take time, the process of thinking through each decision and possible action helps your mind pause to reflect and to be alerted to the importance of the decision. Taking a break at this point allows you to process the information, perhaps while taking a walk or having a lunch break. At some point, you might suddenly have a feeling of knowing the right answer— the decision to make. Sometimes, this experience is attributed to a "gut" feeling or intuition that tells you what you need to do. Resources like Gary Klein's *The Power of Intuition: How to Use Your Gut Feelings to Make Better Decisions at Work* explains how this process works in the human brain. Sometimes, this moment of recognition of the chosen decision results in a decision that wasn't produced through our processes but that offers a new and creative solution.

Taking the time to evaluate and deeply think about the problem, the advice, and possible solutions is an important part of decision making. Just as important are pausing and taking time to select a decision that is not reactive and that you feel comfortable with, keeping in mind that the decision you make might be unique, and the actual decision might not be within the advice provided to you by your support group. As the lead entrepreneur whose goal is the success of the venture, you are ultimately responsible for the decision. If the advice provided doesn't feel right, make the decision that does feel right and make sure you communicate that decision with your team.

15.4 Now What? Serving as a Mentor, Consultant, or Champion

Learning Objectives

By the end of this section, you will be able to:

- Evaluate potential next steps after exiting the venture
- Explain the roles of mentors, consultants, and champions

Depending on your experience as a first-time entrepreneur, you have a new set of choices in front of you. If you enjoyed the experience, felt the thrill and excitement of taking an idea from launch through to the successful harvesting of the venture, you might want to become involved in another new venture—that is, maybe your path is to become a serial entrepreneur. Or, after all that work, you might want to spend some extended time traveling or with family. You might want to consider ideas for giving back to the entrepreneurial community or becoming a social entrepreneur in your next venture. You might want to take some of your earnings from the harvest and become an angel investor. These decisions depend on your experience as an entrepreneur and money and less-tangible resources you gained through harvesting the venture. Having undergone a positive experience, gained significant learning, and harvested substantial funds often leads an entrepreneur into becoming a mentor, consultant, or champion for another entrepreneurial project. Think back to all the people who helped you get to where you are today. Where would you be without their help? Giving back to others continues the creation of **social capital**, the goodwill we create by giving back to individuals, organizations, and communities.

Mentors

Mentor motivation includes the satisfaction of helping and guiding other entrepreneurs through the challenges of starting, growing, and harvesting their venture. Mentors can participate through formal government organizations such as SCORE, or organizations similar to Y Combinator, or from an internal aspect such as an advisory group membership. Mentors provide assistance and advice based on their previous experience as an entrepreneur, or as a content expert within a narrowly defined area related to the new venture’s product or service. Specific areas of expertise might include commercialization of a new technology, safeguarding intellectual property, marketing, or funding sources for a nonprofit social entrepreneurship venture. Just as there can be an alignment between an angel investor’s knowledge and skill set to the entrepreneurial venture, mentors should also seek ventures where they can provide key insights and knowledge. Mentoring in this capacity as a former entrepreneur is more rewarding when there is an interest in the opportunity and the entrepreneurial team.

Identifying exactly what the mentor can provide and what the entrepreneurial team needs is an important part of this relationship. Both parties should discuss time commitments and expectations as part of this relationship. Mentoring requires considerable commitment and can include support for complex topics and difficult decisions. In return for this help, mentors receive satisfaction, rejuvenation, personal growth, new relationships and connections, and a feeling of philanthropic motivation.

There are also risks in taking on the role of a mentor. One risk relates to providing advice that later proves to be detrimental to the venture. Another risk is the perception that the mentor provided direction when the mentor in fact provided suggested options that the entrepreneurial team should consider in its decision. A third risk concerns confidentiality and non-compete covenants. New ideas generate additional ideas, and as a startup team fine-tunes its opportunity and venture, some ideas will be rejected. From your perspective as a mentor and former entrepreneur, you might realize that you could develop one of the rejected ideas into a successful business. This situation can present conflicts of interest between you as the mentor and the venture that you are mentoring.

Because of these risks, as well as the contributions made by the mentor, some sources believe that the mentor should receive financial compensation and enter into a contractual relationship that addresses these risks. Possible financial payments include equity in the venture, profit sharing, or a retainer fee.

Consultants

Another role you might want to consider is becoming a consultant, a position more formally defined than mentorship. You might even want to create your own consulting company focused on entrepreneurs as your target market, or select a narrower target market such as a segment within the entrepreneurial world. In considering starting your own consultant business, your start-up process is similar to the topics addressed throughout this book. Identify your own strengths and interests, identify other needs that your target market would value, and develop a business plan. Acting as a consultant contributes back to the entrepreneurial world, provides you with the enjoyment of active involvement in areas where you excel, and bolsters to your financial worth.

Champions

Great Britain offers an Entrepreneur Champion of the Year award in recognition of the importance of having support in starting a new venture. Although we don't have that award in the United States, we recognize how important support is to become successful. The Startup Champions Network is a startup organization located in Boulder, Colorado. This organization supports and connects entrepreneur-related champions: people who build and lead coalitions that create and advance resources for entrepreneurs. The Startup Champions Network seeks people who support a history of supporting entrepreneurship and innovation within their communities, recognize and model inclusiveness and collaboration skills, enjoy helping other people and work well with people, embrace humility, are action oriented, and focus on possibilities. Forbidden behaviors include being driven by self-interest, being focused on earnings or control of earnings, and lacking experience or a long-term focus.[11]

Regardless of your interest in joining a formal champion group or acting in an individual capacity, becoming a champion to promote and assist another entrepreneur provides personal growth, satisfaction, and rewarding involvement within the entrepreneurial community. Many of the characteristics desired by the Startup Champions Network reflect research related to effective leaders. Most states have organizations that support entrepreneurs, from business plan development and decision making through opportunities to give back to the entrepreneurial world in whatever capacity a person desires. Take a few minutes to research opportunities in your state and community, and consider how your own future might align with these organizations.

These choices give you some ideas on what you might want to do now that you have harvested your venture. After tasting the excitement of starting, growing, and harvesting your venture, you have a new set of options to consider from becoming a serial entrepreneur through adding value to other entrepreneur's potential successes to becoming a social entrepreneur.

ENTREPRENEUR IN ACTION

Solving Global Health Issues

The American Society of Tropical Medicine & Hygiene (ASTMH) is the largest international scientific organization dedicated to reducing tropical infectious diseases and improving world health.[12] Diseases like malaria, Dengue fever and Zika are transmitted by mosquitoes and are increasing in frequency.

11 Startup Champions Network. http://www.championsnetwork.co/
12 American Society of Tropical Medicine and Hygiene. https://www.astmh.org/about-astmh/who-we-are

These diseases reduce an infected person's quality of life and can impact their ability to earn a living by reducing energy and the capacity to carry out day-to-day activities. These afflictions can also result in other painful complications, coma, and even death through kidney failure. According to ASTMH, close to half of the world's population lives in areas at risk of contracting malaria. The map in Figure 15.12 provides a view of how vast the potential area is for malaria infestation. Even noting the shaded light green areas as formerly malarious, these areas could once again be infested with malaria-carrying mosquitoes. As the planet's temperature increases, disease-carrying insects become more pervasive, entering geographical areas where some of these tropical diseases never existed. Read this article about major tropical diseases (https://openstax.org/l/52TropDisease) to learn more.

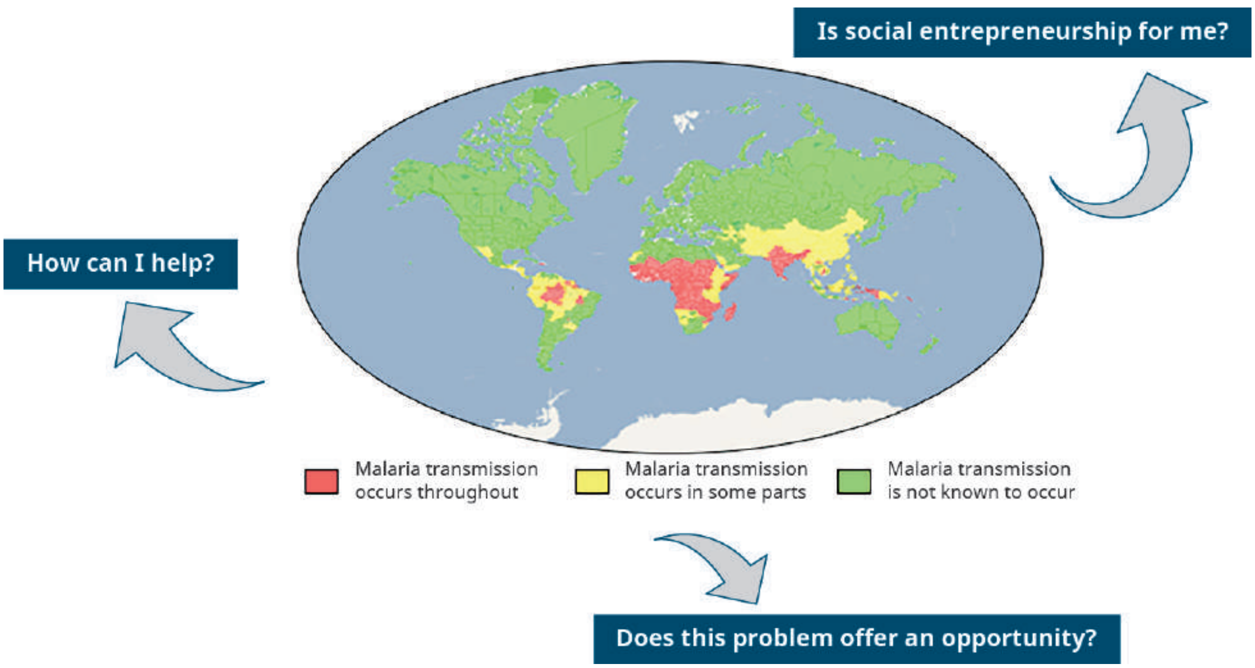


Figure 15.12 What can you do to help solve this global problem? What potential solutions might also be entrepreneurial opportunities?

15.5 Reflections: Documenting the Journey

Learning Objectives

By the end of this section, you will be able to:

- Examine the value of journaling and reflection
- Experiment with reflection as a daily habit

Figure 15.13 Taking the time to record your thoughts and activities provides new learning opportunities. (credit: “Journaling” by Vic/Flickr, CC B 2.0)

Consider the journey of learning about entrepreneurship and of becoming an entrepreneur. What new knowledge have you gained about the world of entrepreneurship? What have you learned about your own interests in becoming an entrepreneur? Discovering your interest in specific areas helps to inform the possible entrepreneurial opportunities you might want to pursue and informs you of specific processes and actions where you might excel within an entrepreneurial endeavor. Consider how you can add value to an entrepreneurial team as a team member, or in the capacity of a mentor, consultant, or champion, as you reflect on your own interests, goals, passions and desires.

The Power of Journaling

Reflection supports personal growth through identifying actions that worked well and actions that didn’t work out as well as hoped. A formal reflection journal for capturing daily thoughts, experiences, lessons learned, and other material, can lead to insights and identify patterns in thinking and in behaviors that may be helpful to recognize—both for personal growth and for growth as an entrepreneur.

In daily life, people seldom have the time or training to be mindful of their actions—to be aware of how they interact with others, or how they act in the variety of situations that fill their days. A daily practice of reflection can improve your ability to be mindful throughout the day and to grow through your documented reflections. Being mindful is the action of being in the moment, being aware of surroundings and fully engaged in awareness of the people around us, hearing their communications and understanding the complexity of their messages. Mindfulness moves us out of our *reaction* to situations from our own personal perspective into a more *objective awareness*—a bit like viewing your life as though you were watching it as a spectator on the sidelines. This change in perspective moves us away from reacting to situations and toward a clearer, unbiased, and focused understanding of the situation with awareness of the situation’s nuances. As we develop the practice of mindfulness, we become skilled at being aware of our own emotions and patterns, which can make us aware of more options about how we want to respond: Rather than acting in a habitual or reactive manner, we can consider responses before we react. Reflection is the first step in developing this skill.

Take a few minutes to reflect on your life up to this point. Can you identify milestones, significant decision points, and understand why you made these decisions? Forming a daily habit of writing down your thoughts about the day, challenges you faced and how you responded to each, tracking what went well and what didn't go well is the process of reflection. Over time, you will begin to see patterns in your behaviors. Identifying these patterns or habits provides key insights into how you think, process information, make decisions, and react to decisions. Once you notice these patterns, you have the power to analyze them and decide which are helpful and which are not. The patterns that are not helpful should be removed and replaced with better patterns. You can write down the new patterns that you want to develop as a goal in your daily reflection journal. You can then identify if you're moving closer to following the new pattern and achieving this goal.

This type of journaling activity might seem like busy work, or you might think that you don't have time for reflection. If this is how you feel, try following this advice for a couple of weeks and then reconsider, or conduct your own research to find articles that discredit reflection. There is a vast body of research that supports reflection as an important part of self-growth and self-realization. Some documented benefits in these studies include learning from mistakes, discovering new insights and ideas, and increases in reported happiness and satisfaction with life and relationships, increased mindfulness, and increased self-understanding resulting in feeling more power to choose how one interacts with the world—feeling empowered rather than the victim of a situation.[13],[14],[15]

The Impact of Reflection

Gino and Staats noted four categories that hinder success; "biases cause people to focus too much on success, take action too quickly, try too hard to fit in, and depend too much on experts."[16] Their point is that the focus on action and success can get in the way of being successful, or of even knowing what success looks like. Gino and Staats' research identified challenges related to the category of the focus on success. The first three challenges related to the bias toward success include the fear of failure, a fixed mindset, and overreliance on past performance, topics discussed earlier as impediments to the entrepreneurial team's success and ability to recognize the need for adaptability[17]. Under the concept of a bias toward action, Gino and Staats identified two challenges: exhaustion and lack of reflection. Exhaustion prevents entrepreneurs from contributing at top—or even normal—levels, while a lack of reflection reduced performance by 20 percent, according to their findings.[18] Lack of reflection not only decreased performance but also decreased individual, team, and organizational learning. The U.S. Army uses a system of after-action reviews to reflect on actions, successes, and opportunities for improvement. Another common name for this type of reflection in the business world is post-mortem or lessons learned: the action of reflecting on projects or decisions to identify best practices and areas for improvement. Consider the medical community: What would happen if after every surgery or medical diagnosis, no one analyzed the consequences of the surgery or diagnosis? Might we still be using mercury to kill germs or leeches for bloodletting?

The last two biases identified by Gino and Staats are a bias toward fitting in and a bias toward experts, with two sub-challenges within each area. Under bias toward fitting in, the first challenge is believing you need to conform, and the second challenge is failure to use your strengths.[19] The pressure to conform is present throughout our lives. We are taught to form a line to enter the kindergarten class, the movie theater, or the

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13 Cable Neuhaus. "The Multimedia Journal: More Than Just a Notebook." *Saturday Evening Post*, *289*(6), 16. December 5, 2017.
14 Deborah L. Starczewski. "Encouraging Students to Think Beyond the Course Material: The Benefits of Using Reflective Journals". *Teaching Professor*, *30*(8), 5. October 2016.
15 J. L. Nelson. Express Yourself. *Scholastic Parent & Child*, *19*(1), 52–54. 2011.
16 Francesca Gino and Bradley Staats. "Why Organizations Don't Learn." *Harvard Business Review*, 93(11), 112. November 2015.
17 Francesca Gino and Bradley Staats. "Why Organizations Don't Learn." *Harvard Business Review*, 93(11), 112–113. November 2015.
18 Francesca Gino and Bradley Staats. "Why Organizations Don't Learn." *Harvard Business Review*, 93(11), 114. November 2015.
19 Francesca Gino and Bradley Staats. "Why Organizations Don't Learn." *Harvard Business Review*, 93(11), 116. November 2015.

cafeteria. We are taught to raise our hand to ask or answer a question. This training to conform makes perfect sense in some situations, but we also need to feel comfortable following a different path or approach to living our lives. Again, reflection can help entrepreneurs recognize when they feel pressured to conform through a closer awareness of inner thoughts and feelings. Increased awareness of our thoughts and feelings often leads to more confidence in expressing our thoughts. Following this process also contributes to recognizing your strengths.

In the findings about bias toward experts, the two challenges identified are an overly narrow view of expertise and inadequate frontline involvement. The dependence on experts can create a situation where entrepreneurs assign responsibility for the information and/or decision-making to someone who might have an area of expertise, without realizing that an expert would not be aware of the complexities present within the venture. The expert likely has a pattern or system that has been success for other companies and in other situations, but this advice might not represent the best information or advice for your venture. Involving the frontline team, as well as other sectors of your venture, in discussions and decision-making presents multiple perspectives well worth accessing.

As you build the habit of reflection in your life, and even within your venture, consider how the challenges discussed frame your reflections. Have you made decisions because you wanted to fit in? Do you and your team have a narrow definition of expertise? Did someone give you a key insight that you disregarded because this person did not fit your picture of an expert or informed person? Are you involving the right people in discussions?

Documenting Your Journey

As part of your reflection activity, another benefit is to document your journey. If you have identified an opportunity or have started to build your venture, now is the perfect time to keep a journal and document your journey. Each day you face new challenges and exciting ideas that stretch your own learning and growth. Tracking the daily events provides you with a roadmap to use for your next venture, or as a guide to build your knowledge base in moving into a mentor or consultant role. Have you ever asked yourself, why didn't I write that down? We assume that important and insightful ideas will stick in our minds and that we will readily remember them. But in reality we often forget these key insights and ideas. Through journaling, we can record and reflect on our daily activities and key insights.

LINK TO LEARNING

This TED Talk on creatives by Adam Grant (https://openstax.org/l/52ThinkersTED) presents some of the concepts of this chapter, framed around Dr. Grant's research as a professor at the Wharton School of Business at the University of Pennsylvania, on creatives. His book, *Originals: How Non-Conformists Move the World*, shares more of his findings.

Are there biases and habits that hold you back from being a creative, as defined in this chapter and by Dr. Grant? If so, what methods can you use to break through these biases and habits?

Key Terms

burn rate rate at which cash outflow exceeds cash inflow
buyback clause legal agreement regarding an exit by a founding team member prior to the harvesting of the venture
code of conduct formal statement that provides guidance on how ethical conduct is demonstrated
company culture shared beliefs, values and assumptions held by people regarding how to behave or conduct themselves within the context of fitting into an organization
Delphi method group decision-making process that includes a diverse group of people who are located at different locations and willing to respond to a series of questionnaires to assist in providing ideas, information or solutions to a defined question or problem
escalation of commitment tendency to continue with a predetermined action based on the past efforts and contributions to the project rather than an analysis of the current realities that disclose a new solution or approach is necessary
fail-safe point identified point that triggers the entrepreneur to consider what actions are needed to bring the venture back to a healthy position and whether this action is reasonable and feasible
founders' agreement written document that addresses contractual topics such as division of equity, compensation, contributions to the venture, and commitments to the venture with timelines included
Gannt chart bar chart used to organize and plan sequential steps in a process
hindsight bias belief that, in retrospect, the outcome was predictable when the outcome wasn't predictable due to various uncontrollable factors
hubris overinflated belief in oneself
lifestyle business business that provides incomes similar to other forms of employment
Nominal Group technique group decision-making process that requests multiple rounds of responses and discussions of response
noncompete agreement formal agreement that the person signing the document will not work for another organization that is a direct competitor of their current employer during employment and usually for a specified length of time after employment ends
nondisclosure agreement formal agreement that the person signing the document will not sharing proprietary information with outside sources
planning fallacy creation of a plan that is too optimistic and not aligned with conservative assumptions
serial entrepreneur entrepreneur who becomes involved in starting multiple entrepreneurial ventures
social capital goodwill that is created through helping someone else
status quo bias pattern of relying on previous actions and results as the accepted pattern and outcome with a bias against change or new information or new results

Summary

15.1 Launching Your Venture

Before launching a venture, the entrepreneurial team should ensure its members agree on the vision and then develop a founder's agreement. The company culture should be defined, and a code of conduct developed. The team should identify all operational tasks needed to launch the venture and their associated time requirements and dependencies. Staying openminded and flexible at launch can help support the venture's success.

15.2 Making Difficult Business Decisions in Response to Challenges

Some of the same characteristics that make entrepreneurs successful (such as confidence and optimism) can sabotage success. Entrepreneurs should be aware of potential biases or thinking patterns that obfuscate the current reality of the venture so they are able to recognize key problem indicators and put solutions in place. Some of the more difficult decisions an entrepreneur makes are difficult because of the emotional connection to previous decisions or decisions that affect other people involved in the venture. Early agreement that the success of the venture is the primary focus can help to work through these difficult decisions.

15.3 Seeking Help or Support

Entrepreneurs should recognize the wisdom in seeking help and support as they plan, launch, and grow their ventures. Sources of advice include the entrepreneur's own network, the connections of the start-up team, and angel investors and their resources. Tools to assist in decision making include the Delphi method and the Nominal Group technique.

15.4 Now What? Serving as a Mentor, Consultant, or Champion

Once you become an entrepreneur, you can consider giving back to the entrepreneurial community by becoming a mentor, consultant, or champion to support other people in their ventures.

15.5 Reflections: Documenting the Journey

Reflection and journaling are useful tools for entrepreneurial growth. These practices can help you to identify patterns that act as obstacles, to brainstorm solutions, to set goals, and to document ideas that may lead to your next venture.

Review Questions

1. A nondisclosure agreement protects the venture by ________.

A. outlining confidential information or knowledge that the parties do not want to share with outside, or third, parties and is considered a legally binding contract
B. sharing information that is not confidential
C. identifying key people who can access confidential information
D. identifying disclosed information for outsider use

2. Which of the following documents should be discussed and agreed upon prior to the start of the venture?

A. nondisclosure and noncompete agreements
B. nondisclosure and founder's agreements
C. founder's agreement and a code of conduct
D. founder's, nondisclosure, noncompete agreements, and code of conduct

3. The founder's agreement includes which of the following content items?

A. non-disclosure clause
B. personnel plan
C. buyback clause
D. marketing plan

4. According to some research on entrepreneurs, what is/are the most significant bias(es)?

A. small numbers allow for niche markets
B. entrepreneurs prefer taking action rather than planning
C. entrepreneurs tend to be over confident and optimistic
D. entrepreneurs fall for the planning fallacy

5. The law of small numbers refers to:

A. an inability to attract a large target market
B. a target market that is too small to lead to success
C. a target market that aligns with key stakeholders
D. both a and b

6. Why is it important to keep track of your assumptions?

A. Knowing the assumptions provides background information related to the projected outcomes or numerical projections.
B. Knowing the assumptions provides an opportunity support your biases.
C. Assumptions are never accurate and are therefore discredited.
D. Assumptions constantly change and therefore do not need to be tracked.

7. The Nominal Group technique ________.

A. is only used in complex decisions
B. has multiple uses for gaining feedback from participants
C. can be used with only one participant
D. restricts participant participation

8. The Delphi technique ________.

A. requires participants to be in one location
B. requires participants to come prepared to the activity by researching the problem
C. requires time and commitment
D. requires collaboration in answering the questionnaire

9. Acting as a mentor provides ________.

A. expert assistance to the venture startup team and self-growth for the mentor
B. opportunities to diminish relationships
C. the mentor with professional development
D. the mentee with peer recognition

10. A serial entrepreneur is someone who ________.

A. wants to retire
B. creates a pattern of starting multiple ventures
C. plans for a low stress future
D. plans to start the first venture

11. Benefits of a reflection journal include which of the following?

A. identifying patterns, biases, habits and discovering new insights
B. assigning new work responsibilities
C. identifying wasted time
D. avoid reviewing decisions that can’t be changed

12. Reflection journal is similar to ________.

A. a post mortem
B. a time log of your activities
C. a scrapbook of pictures
D. a record of assumptions

13. According to Dr. Grant, creatives are people who ________.

A. are procrastinators
B. act on multiple ideas
C. plan out each detail
D. are highly confident with no doubts about their success

Discussion Questions

1. Why should the entrepreneurial team begin with the end in mind?

2. How can a Gantt chart help in the preparation for starting the new venture?

3. Why would an angel investor stress to the startup team the importance of not getting too attached to the venture?

4. Should employees who are not part of the startup team receive an equity position in the venture? What are the benefits and drawbacks that inform this decision?

5. What biases might an entrepreneur encounter in starting the venture?

6. What actions can the entrepreneur take to avoid these biases?

7. What can be done to avoid personnel problems that occur after the venture has opened?

8. How can brainstorming and creating a mindmap improve problem recognition and follow through actions?

9. What are three methods you could use to find support for your new venture?

10. Why is it important to analyze and discuss decisions?

11. Why is it important to feel comfortable with a decision?

12. What are the benefits in becoming a mentor, consultant or champion?

13. What are the risks or drawbacks in becoming a mentor, consultant or champion?

14. How does a philanthropic desire align with entrepreneurship?

15. What can you do to avoid the challenges presented through Gino and Staats’ research?

16. What can you do to role model behavior that reflects your learning of the material in this chapter?

Case Questions

1. Review the information on YouTube in this section of the chapter and conduct your own research. What evidence is there that beginning with the end in mind was part of YouTube’s founders original plan?

2. Review the LuminAid story. Why did Sreshta and Stork focus on light as their business idea instead of a focus on other areas needed by survivors of a natural disaster?

3. Refer to Stacy Madison’s food cart story. What was the most important insight you gained from reading about Stacy’s food cart business?

4. Everlane started as an online clothing store focused on ethical business practices. Part of their commitment to ethical practices includes regular visits to their factories to ensure people receive fair wages and work reasonable hours, addressing environmental concerns, and being transparent in decisions and transactions, such as disclosing the cost to produce an article of clothing. With $100 million in revenue in 2016 and over 44,000 people on the waiting list for a new line of denim available this September 2018, Everlane is shaking up the fashion industry. If your new venture faced this type of competition, what actions would you take? Consider if you would adopt this same transparency strategy, become more involved in the supply chain to determine how clothing factory workers were treated at your offshore factories owned by other entities, increase brand name marketing to support the profit markup on your clothing, or some other action? What process would you use to make these decisions?

Suggested Resources

15.1 Launching Your Venture

R. Nanda, L. Kind, K. Laws, & J. Lum. "Case Study: Is a Start-up's Strength Becoming Its Weakness?" *Harvard Business Review* 93, no. 11 (2015): 145.

Ablebit’s instructions for making a Gantt chart in Microsoft Excel: https://www.ablebits.com/office-addins-blog/2014/05/23/make-gantt-chart-excel/

Smartsheet’s step-by-step instructions for making a Gantt chart in Microsoft Excel: https://www.smartsheet.com/blog/gantt-chart-excel

Project Manager’s Ultimate Guide to Gantt Charts: https://www.projectmanager.com/gantt-chart

The Startup Checklist by David Rose, founder of NY Angels and GUST.com

Shortcut: How Analogies Reveal Connections, Spark Innovation, and Sell Our Greatest Ideas by John Pollock discusses using analogies to think about unmet needs and innovative solutions.

15.2 Making Difficult Business Decisions in Response to Challenges

“How Fast Can Your Company Afford to Grow?” *Harvard Business Review*, 1998. Classic article serves as a good reference on cash flow and self-financed growth, covering key levers to help manage profitable growth without having to go “hat in hand” to investors again.

The Undoing Project by Michael Lewis provides a good reference on biases through the story of psychologists Amos Tversky and Daniel Kahneman.

“3 Steps to Determine Product-Market Fit”, *Entrepreneur Magazine*, August 2014. Good reference on product-market fit.

What Customers Want, by Ullrich, discusses “Jobs to be Done” theory created by Clayton Christensen and practice by Strategyn.

https://www.npr.org/podcasts/510313/how-i-built-this

15.3 Seeking Help or Support

Service Corps of Retired Executives (SCORE): https://www.score.org/

Small Business Administration: https://www.sba.gov/

Y Combinator: http://www.ycombinator.com/

Techstars: www.techstars.org

G. Klein. *The Power of Intuition: How to Use Your Gut Feelings to Make Better Decisions at Work*. (New York: Doubleday, 2004)

15.4 Now What? Serving as a Mentor, Consultant, or Champion

The Case Foundation: https://casefoundation.org/

Startup Champions Network: http://www.championsnetwork.co/

15.5 Reflections: Documenting the Journey

F. T. Evers. Journaling: A Path to Our Innermost Self. *Interbeing*, 2, no.2 (2008): 53–56.

D. Ciampa. The More Senior Your Job Title, the More You Need to Keep a Journal. *Harvard Business Review Digital Articles* (2017): 2–4.

Worklife TED-sponsored podcasts: https://itunes.apple.com/us/podcast/worklife-with-adam-grant/id1346314086?mt=2

NPR podcast “How I Built This” founder/CEO podcasts: https://www.npr.org/podcasts/510313/how-i-built-this

A Suggested Resources

These suggested resources can help you review and refine your entrepreneurial plans.

Entrepreneurial and Small Business Support (General)

Small Business Administration (SBA): www.sba.gov

Small Business Administration site of local organizations that might assist you in launching or managing a venture: https://www.sba.gov/tools/local-assistance

Service Corps of Retired Executives (SCORE): https://www.score.org/

Small Business Development Center (SBDC): https://www.sba.gov/offices/headquarters/osbdc/resources

International Franchise Association: https://www.franchise.org/

US government contracts: https://www.sba.gov/federal-contracting/contracting-guide/basic-requirements

US Department of Commerce: https://www.commerce.gov/

US Department of Commerce, Bureau of Economic Analysis: https://www.bea.gov/

US Department of Labor: https://www.dol.gov/

US Department of Labor, Bureau of Labor Statistics: https://www.bls.gov/bls/blswage.htm

US Chamber of Commerce: https://www.uschamber.com/

Global Entrepreneurship Monitor: http://www.gemconsortium.org/

Entrepreneurial and Small Business Support (Specific Groups)

Women's Business Center (WBC): https://www.sba.gov/local-assistance/find/?type=Women%27s%20Business%20Center&pageNumber=1

Veterans Business Outreach Center (VBOC): https://veteransoutreachcenter.org/

National Association of Women Business Owners: https://www.nawbo.org/resources/women-business-owner-statistics

Asian American Chamber of Commerce: http://www.asian-americanchamber.org/

Black Chamber of Commerce: https://www.nationalbcc.org/

Hispanic Chamber of Commerce: https://ushcc.com/

Ladies Who Launch: https://www.ladieswholaunch.org/

Minority Business Development Agency: https://www.mbda.gov/

National Association of Professional Women: http://womenforhire.com/company/national-association-of-professional-women-napw/

The Female Entrepreneur Association: https://femaleentrepreneurassociation.com/

Women's Business Enterprise National Council: https://www.wbenc.org/

Vision Statement, Mission Statement, and Goal Setting

Website with ideas for developing your vision: https://www.executestrategy.net/blog/write-good-vision-statement

Video with walkthrough for crafting your mission statement: https://www.entrepreneur.com/article/65230

Eleven Free Goal Setting Software and Tools You Can Use: http://www.goal-setting-college.com/goal-setting-software/11-goal-setting-software-tools-you-can-use-for-free/

YouTube: Achieve More by Setting Smart Goals: https://www.youtube.com/watch?v=yA53yhiOe04

Business Models and Business Plans

SBA Business Plan resources: https://www.sba.gov/business-guide/plan-your-business/write-your-business-plan

Business Model Canvas: https://strategyzer.com/canvas/business-model-canvas

Business model canvas and resources: Strategyzer.com

Lean canvas and associated resources: Leanstack.com

Social business model canvas and related resources: Socialbusinessmodelcanvas.com

YouTube Video: Business Model Canvas Explained: https://www.youtube.com/watch?v=QoAOzMTLP5s

The Four Lenses Strategy Framework website: www.4lenses.org

List of Social Enterprise Business Models or Frameworks: http://www.thesedge.org/socent-spotlights/22-awesome-social-enterprise-business-ideas

YouTube Video: We have a dream, B-corp overview and mission: https://www.youtube.com/watch?time_continue=3&v=V-VFZUFJwt4

Sample business plans-www.bizplans.com: www.bplans.com

Funding, Finances, and Accounting

Small Business Administration (SBA) lending program: https://www.sba.gov/funding-programs/loans

Small Business Administration (SBA) calculation of startup costs: https://www.sba.gov/business-guide/plan-your-business/calculate-your-startup-costs#section-header-6

Small Business Administration, “How to Start a Non-Profit”: https://www.sba.gov/blogs/how-start-non-profit

US Department of Labor: https://www.dol.gov/general/topic/statistics/wagesearnings

Tax information for charitable organizations from the Internal Revenue Service: https://www.irs.gov/charities-non-profits/charitable-organizations

Grant information by state: https://www.grants.gov/

Information from the National Institutes of Health on grants and the application process: https://grants.nih.gov/grants/about_grants.htm

G-Startup Worldwide’s global startup competition: https://www.f6s.com/g-startupworldwide/

Extending Credit to Your Customers: https://fitsmallbusiness.com/invoicing-extending-credit-to-customers/

7 Ways to Bootstrap Your Business to Success: https://www.entrepreneur.com/article/254217

Small Business Administration Introduction to Accounting Course: https://www.sba.gov/tools/learning-center-view-course/364071

Khan Academy Accounting and Financial Statements Course: https://www.khanacademy.org/economics-finance-domain/core-finance/accounting-and-financial-stateme

U.S. Securities and Exchange Commission: https://www.sec.gov/reportspubs/investor-publications/investorpubsbegfinstmtguidehtm.html

US Securities and Exchange Commission Regulatory Actions: https://www.sec.gov/rules.shtml

SEC Information on crowdfunding portals: https://www.sec.gov/divisions/marketreg/tmcompliance/fpregistrationguide.htm

Link to SEC (FINRA) crowdfunding portals: https://www.finra.org/about/funding-portals-we-regulate

Money and Interest Rates: https://www.federalreserve.gov/data.htm

Y Combinator: http://www.ycombinator.com/

Techstars: www.techstars.org

Kickstarter: www.kickstarter.com

Indiegogo, “The Essential Guide to Crowdfunding”: https://learn.indiegogo.com/the-essential-guide-to-crowdfunding/

Startupfest, “The $100K Investment Prize”: http://www.startupfestival.com/news/100k-investment-prize/

Circleup: http://circleup.com

Exilend: https://www.exilend.com

Fundable: http://fundable.com

LendingKarma: http://www.lendingkarma.com

LoanBack: http://loanback.com

Trade Show News Network: http://www.tsnn.com

ZimpleMoney: http://www.zimplemoney.com

Legal Issues in Entrepreneurship

SBREFA Small Business Resource Center’s site on legal requirements and regulatory compliance: https://www.dol.gov/agencies/oasam/business-operations-center/osdbu/compliance-assistance

U.S. Patent and Trademark Office: https://www.uspto.gov/

Nondisclosure (NDA) templates: https://www.rocketlawyer.com/

US Small Business Administration on licenses and permits: https://www.sba.gov/business-guide/launch-your-business/apply-licenses-permits

Internal Revenue Service (IRS) information on taxation in partnerships: https://www.irs.gov/businesses/small-businesses-self-employed/partnerships

Information on variation between all 50 states in forming or incorporating a business from Cornell Law School: https://www.law.cornell.edu/wex/corporations

US Copyright Office: https://www.copyright.gov/help/faq/faq-protect.html

Federal Communications Commission on cybersecurity for small businesses: https://www.fcc.gov/general/cybersecurity-small-business

North Carolina State University Poole College of Management’s risk management initiative: https://erm.ncsu.edu/library/article/coso-erm-framework

US Copyright Office: https://www.copyright.gov/

Marketing

Small Business Administration information on marketing and sales: https://www.sba.gov/business-guide/manage-your-business/marketing-sales

American Marketing Association (AMA): https://www.ama.org

American Marketing Association (AMA) digital marketing certification: https://www.ama.org/events-training/Certification/Pages/digital-marketing-certification.aspx

American Marketing Association (AMA) on-demand course: Digital Marketing: Delivering a Custom Experience: https://www.ama.org/events-training/virtual-events/Pages/digital-marketing-virtual-conference-051717.aspx

Google Ads: https://ads.google.com/home/

Pitching

Harvard Business Review's how to craft a corporate narrative: https://hbr.org/2016/03/how-to-build-a-strategic-narrative

Pitch deck templates: https://articles.bplans.com/what-to-include-in-your-pitch-deck/ and https://www.forbes.com/sites/allbusiness/2017/03/04/how-to-create-a-great-investor-pitch-deck-for-startups-seeking-financing/#630406bc2003 and https://www.startupgrind.com/blog/the-quick-and-dirty-guide-to-creating-a-winning-pitch-deck/

Operational Resources

Society for Human Resource Management: https://www.shrm.org

Scheduling programs and templates: https://getsling.com/blog/category/scheduling/,

https://wheniwork.com/features, and https://schedulebuilder.org/

Employer hiring costs of employee: https://gusto.com/tools/employer-tax-calculator

Payroll program: https://onpay.com/payroll-calculator-tax-rates

Smartsheet's step-by-step instructions for making a Gantt chart in Microsoft Excel:

https://www.smartsheet.com/blog/gantt-chart-excel

Project Manager's ultimate guide to Gantt charts: https://www.projectmanager.com/gantt-chart

FindLaw Small Business Center (business forms): https://smallbusiness.findlaw.com/

Research Sources for Demographic and Marketing Data

Small Business Administration (SBA) guide on researching your market: https://www.sba.gov/business-guide/plan-your-business/market-research-competitive-analysis#section-header-5

American Fact Finder (market research): http://factfinder2.census.gov/main.html

FedStats (statistics from more than 100 federal agencies): www.fedstats.gov

National Federation of Independent Business: https://www.nfib.com/business-resources

The Small Business National Center: https://sites.google.com/a/uca.edu/sbanc/home

Bureau of Labor Statistics: https://www.bls.gov/bls/demographics.htm

North American Industry Classification System: https://www.census.gov/eos/www/naics/

Statistical Abstract of the United States: https://www.census.gov/library/publications/2011/compendia/statab/131ed.html

US Census Bureau site on where to locate your business: https://cbb.census.gov/sbe/#

Consumer credit data: https://www.federalreserve.gov/releases/G19/

Consumer product safety: https://www.cpsc.gov/

Consumer price index: https://www.bls.gov/cpi/

Bureau of Economic Analysis: https://www.bea.gov/

Employment Statistics: https://stats.bls.gov/bls/employment.htm

Income Statistics: https://www.bls.gov/cps/earnings.htm

American Customer Satisfaction Index: https://www.theacsi.org/

North American Industry Classification System: https://www.census.gov/eos/www/naics/

US Census Bureau: https://www.census.gov/

Tools for Creativity and Problem Solving

Twenty-four essential mindmapping and brainstorming tools: http://mashable.com/2013/09/25/mind-mapping-tools/#jP47h7Q818qM

Open Innovation Community: http://openinnovation.net/

Ideation techniques: http://www.innovationmanagement.se/2013/05/30/the-7-all-time-greatest-ideation-techniques/ and https://www.ideou.com/pages/ideation-method-mash-up and http://www.designkit.org/methods/15

LUMA Institute’s LUMA System of Innovation: https://www.youtube.com/watch?v=qDyElJ0xe2o

Analyze your problem-solving abilities: https://www.mindtools.com

IDEO Design Kit: http://www.designkit.org/resources/1.

Design Thinking Mix Tapes from Stanford’s Design School: https://dschool.stanford.edu/resources/chart-a-new-course-put-design-thinking-to-work.

Lean Startup and Pivoting

Lean startup: http://theleanstartup.com/#principles

Toyota’s Way: https://vimeo.com/44328452

14 Management Principles of Toyota: http://www.panview.nl/en/lean-production/toyota-way-j-liker-summary

Tim Berry’s Lean Business Planning Guide: https://leanplan.com/

Lean canvas and associated resources: Leanstack.com

The International Business Model Competition that focuses on lean startup models, sponsored by BYU and Harvard: http://www.businessmodelcompetition.com/

Networking and Trade Organizations

LinkedIn: www.linkedin.com

Association of Chamber of Commerce Executives: acce.org

BNI: Business Network International: https://www.bni.com

HUBZone: https://www.sba.gov/offices/headquarters/ohp

Tradeshows: http://www.tsnn.com/

Industry research publications: http://www.newslink.org

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