



ENTREPRENEURSHIP & SMALL BUSINESS MANAGEMENT

SECOND EDITION

Steve Mariotti • Caroline Glackin



ENTREPRENEURSHIP & SMALL BUSINESS MANAGEMENT

Second Edition

Steve Mariotti • Caroline Glackin

PEARSON

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Diana Davis Spencer.

—*Steve Mariotti*

To my children, Elise and Spencer, whose support and love
are essential parts of this book.

To my parents, Howard and Maria Wiedenman,
who truly understood the importance
of education. My love and gratitude.

—*Caroline Glackin*

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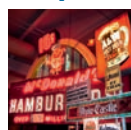
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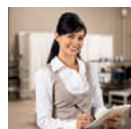
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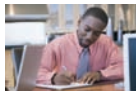
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Preface

Helping Students Own Their Future

Entrepreneurship and Small Business Management (ESBM), Second Edition, is the newest textbook in a line of entrepreneurship textbooks written by Steve Mariotti, founder of the Network for Teaching Entrepreneurship (NFTE). This is the second written with professor and entrepreneur Caroline Glackin, and it promotes entrepreneurship as a career option for college students. It is built on the success of *Entrepreneurship: Starting and Operating a Small Business*, Third Edition, with greatly expanded coverage of the details of managing and growing a small business.

Business students, as well as those from other disciplines, can benefit from *ESBM*. For business students, it recasts their prior learning from a typical corporate context and focuses it on small and entrepreneurial enterprises. For students in such fields as hospitality, the arts, engineering, and fashion merchandising, the text introduces key business concepts and provides examples from a broad range of careers. Cases from hospitality, technology, retail, manufacturing, distribution, real estate, finance, and not-for-profit organizations bring a wealth of learning opportunities. Most importantly, *ESBM 2e* is a balanced mix of the academic and applied components of entrepreneurship education. Students are introduced to the theories, methods, and requisite knowledge and skills required of entrepreneurs and are immediately given practical examples and discussion opportunities. Using the Application Exercises and Exploring Online features at the end of each chapter, they are encouraged to take this new knowledge and apply it in their own lives, so that the course materials are reinforced and internalized.

Highlights of New Content and Changes

Entrepreneurship and Small Business Management, Second Edition, contains new content and some changes, including the following:

- **Eight new Chapter Openers.** These feature more small and entrepreneurial enterprises. New cases are: Bridgecreek Development, Mercedes, Virgin Group Ltd., University Parent, Aravind Eye Care System, Chilly Dilly, inDinero, and Paula Jagemann.
- **Eleven new short End-of-Chapter Case Studies:** Urban Decay, SarahCare of Snellville, Happy Belly Curbside Kitchen, BNI, MooBella, Gentle Rest Slumber, Holterholm Farms, Gelato Fiasco, The Bun Company, Khan Academy, and Anago Cleaning Systems.
- **Seven new longer End-of-Chapter Case Studies:** Foursquare, Wahoo's Fish Tacos, Rosi and Brian Amador, Chilly Dilly's Ice Cream, Airbnb, AYZH, and iContact.

- **All New Unit Cases.** These are more current and relatable for students and include: Spanx, Kitchen Arts & Letters, Inc., Empact, Lee's Ice Cream, ONLC Training Centers, and Honest Tea.
- **Step into the Shoes, Entrepreneurial Wisdom, BizFacts, and Global Impact Features.** These have been updated and expanded with 29 new featured items, including 22 Step into the Shoes, 1 Entrepreneurial Wisdom, 2 BizFacts, and 4 Global Impact Features. These features connect chapter content to business facts and examples to reinforce learning.
- **New Honest Tea Featured Business Plan.** From its early stage funding search, this example provides students with an interesting start-up plan for a company that is also featured in the Unit 6 case.
- **BizBuilder Business Plan Questions.** These have been added to chapters to connect the content to student work using the business plan templates.

Combining Street Smarts and Academic Smarts

Entrepreneurship and Small Business Management, Second Edition, is an extension of the academic programs developed by Steve Mariotti under the auspices of NFTE. Since 1987, NFTE has reached over 500,000 graduates and trained more than 5,000 teachers in 15 countries to impart its innovative entrepreneurship curriculum through its 18 U.S. and 11 international program sites. NFTE is widely viewed as a world leader in promoting entrepreneurial literacy and has a proven track record of helping young people start a great variety of successful ventures.

This textbook unites Steve Mariotti's experience as an entrepreneur with relevant academic theory and practice, supported by a rich variety of examples and stories that include experiences from NFTE program graduates who have started their own businesses. Caroline Glackin brings years of experience in the university classroom, as a lender to small and microbusinesses, and as an entrepreneur and small business owner. Together, these two authors have produced a text that is practical, useful, and academically solid.

Organization

Entrepreneurship and Small Business Management, Second Edition, is organized to follow the life cycle of an entrepreneurial venture from concept through implementation into harvesting or replication. It is a comprehensive text written in light of the reality that college students often take only one course in entrepreneurship and the topic is covered in a multitude of ways. For instructors who will teach the course as a "business plan," *ESBM 2e* offers step-by-step content to build a plan over a semester or a quarter. For those who focus on the management of small and entrepreneurial ventures, there is an abundance of high-quality material on the critical topics of management, human resources, marketing, and operations for such ventures. For those charged with teaching a comprehensive introductory course, all of the components are provided.

Chapter Learning System

Chapter Openers Set the Stage

Each chapter starts with an inspirational quote, Learning Objectives that provide a “road map” so readers know where they are headed, and then an opening case study. The reader connects with a story of a real business in the opening vignette that sets the stage for upcoming material.

Chapter 3

FINDING OPPORTUNITY IN AN EXISTING BUSINESS

Learning Objectives

1. Understand the potential benefits of buying a going concern.
2. Identify potential drawbacks of purchasing a business.
3. Learn how to identify and evaluate purchasing opportunities.
4. Learn how to determine the value of a business.
5. Learn how to negotiate and close the deal.
6. Recognize joining a family business as an entrepreneurial pathway.



“I have found no greater satisfaction than achieving success through honest dealing and strict adherence to the view that, for you to gain, those you deal with should gain as well.”

—Alan Cooper, former Chairman of the Federal Reserve Bank

Many businesses succeed through the entrepreneurial effort of owners who were not the founders. Charles R. Walgreen, Sr. became a store owner in 1891 when he purchased a pharmacy from Isaac Blood in Chicago for \$6,000. Walgreen had worked at the store as a pharmacist and was not satisfied with the quality of customer service there or at pharmacies in general. He had worked in drugstores since he was a teenager. However, he saw value in taking over a business that was already in existence, and started with one that he knew well. Walgreen saw that the neighborhood was thriving, but the store was struggling. It did not take long for Walgreen's innovative approach to store layout and merchandising to reap rewards. He opened a second store in 1899 and by 1912, he had incorporated 20 stores as Walgreen's Inc.

Not content to rest on this success, Walgreen's “stook up” the soda fountain portion of the pharmacy business in 1922 with the invention of the malted milkshake by Ivar “Pop” Coulson, which was a revolutionary product and boosted sales phenomenally. By 1926, Walgreen had opened his 100th store in Chicago, and the company went public the following year. In 1939, upon his founder's death, Walgreen's transitioned the presidency to his son, Charles Walgreen, Jr., illustrating business growth through acquisition, a public stock offering, and generational transfer. This leadership change was followed by continued expansion that resulted in Walgreen's becoming the nation's largest self-service retailer by 1963.

Walgreen's continued to grow and successfully transferred the presidency to that third generation in 1986. The company reached the \$1 billion sales mark in 1995 and opened its 1,000th store in 1984. Charles Walgreen III retired in 1999 but remained on the board of directors. Walgreen's continued its rapid growth trajectory through acquisition, including the acquisition of New York's Duane Reade chain and Take Care Health Systems, adding clinics to its business mix.

Walgreen's is a classic example of entrepreneurial success through acquisition and internal growth.

Many entrepreneurs, like Charles Walgreen, Sr., elect to purchase a going concern rather than starting a business “from scratch.” Others decide to apply their entrepreneurial talents to existing family-owned businesses they buy.



Lightworks Media/Alamy

Source: Walgreen's, Annual Report, March 31, 2009 and July 1, 2013, <http://www.walgreen.com/learning/aboutWalgreen>

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“Step into the Shoes” of the Experts

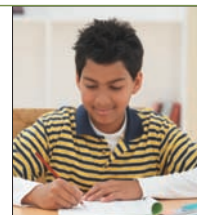
Step into the Shoes appears in each chapter and gives insight into the business practices of entrepreneurs and an opportunity to discuss the brief example. It brings the content to life with real-world application.

Step into the Shoes . . .

Maritza Gonzalez and Noel Cruz—Kumon Math and Reading Center

Kumon Math and Reading Centers, a successful franchisor, had been providing supplemental academic support to students in Newark (New Jersey) Public Schools for four years, through the No Child Left Behind program, when Maritza Gonzalez and Noel Cruz opened a new center there. Maritza is a Kumon parent (that is, a parent of a child in the Kumon system), a product of Newark Public Schools, and a graduate of Montclair State University. For her, the opportunity to direct a Kumon Math and Reading Center is a chance to give back

to the community. Noel Cruz headed up the No Child Left Behind program with Kumon and was an assistant principal at a charter school in Newark. Kumon is a 54-year-old after-school math and reading program with 26,000 centers in 47 countries (more than 1,500 in the United States) that totals more than four million students globally.³



Stockbyte/Thinkstock

*Kumon, accessed June 23, 2009, and July 1, 2013, <http://www.kumon.com/AboutUs>.

BizFacts

BizFacts impart useful information regarding entrepreneurship statistics, company practices, or business applications.

BizFacts

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

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

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

Entrepreneurial Wisdom

Entrepreneurial Wisdom contains insights or advice that will help students in the preparation of a business plan or management of an enterprise.

Entrepreneurial Wisdom . . .

A new business usually will require time before it can turn a profit. Federal Express, in fact, suffered initial losses of a million dollars a month! But if you are not making enough money to stay in business, that is the market speaking. It is telling you that your business is not satisfying consumer needs well enough. Do not take it personally. Many famous entrepreneurs opened and closed a number of businesses during their lifetime.

Henry Ford failed in business twice before the Ford Motor Company was a success. If you want to be a successful entrepreneur, start growing a thick skin and decide right now that you intend to learn from failures and disappointments. Do not let them get you down. Learn, so that you do not make the same mistakes again.

Global Impact

Global Impact, featured in each chapter, provides examples of entrepreneurial ventures around the world or information that can be applied in global trade.

Global Impact . . .

Raw Material Prices Challenge Manufacturers

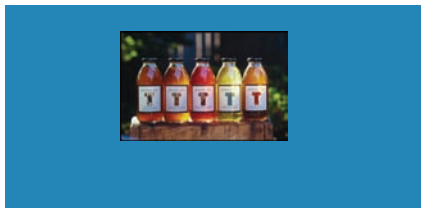
When the price of crude oil rises, much of the world feels the pain. Manufacturers using crude oil in their production are affected. When copper prices rise, the effects are also felt worldwide. Volatile raw-material costs in one area can have huge ripple effects on prices around the world. Whereas labor costs frequently are perceived to be a primary driver of manufacturing costs, the impact of changing raw materials prices may also be quite significant, particularly when they are volatile. Manufacturers must control raw material costs to create sustainable profits.

Manufacturers have to buy smarter, explore alternate materials, and evaluate their ability to increase prices for their customers. Manufacturers source potential materials to purchase globally to attain the most favorable pricing, making any changes an international issue. Thus, a price increase in crude oil in Saudi Arabia has ripple effects on Main Street U.S.A.

Source: Jill Jusko, "Rethinking Raw Materials," *IndustryWeek.com*, August 1, 2006, accessed March 29, 2009, <http://www.industryweek.com>.

New! Honest Tea Business Plan

This is the plan developed by founders Seth Goldman and Barry Nalebuff during Honest Tea's first year of operations. It appears following Chapter 4 and includes a comprehensive market analysis and detailed historical financials. The business raised over \$1 million at a time when sales were less than \$250,000 and the company had operating losses. The Honest Tea plan is an excellent example for students and one that many of them will intuitively understand as customers of bottled tea.



Business Plan for 1999
December 1998
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Bethesda, Maryland 20814
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Our tea leaves are provided by internationally known companies that specialize in tea buying, blending and importation. Our primary source is Hilsbert & Lyon of Germany, the largest specialty tea company in the world. Another, Assam Tea Traders, has direct tea tea estates in the Assam District of Northern India. The other ingredients are commodities which are plentiful supply.

As the Company grows in size, we anticipate dealing more directly with the tea growers. We intend to visit the tea estates so that we can verify that the labor conditions of the tea workers meet international standards and International Labor Organization conventions. We also want to ensure that the tea is grown organically.

Market Opportunity

Beyond Snapple—The Emerging Market for Quality Bottled Tea

We have identified four market trends that are fueling demand for Honest Tea within the \$72 billion non-alcoholic, hard-softened beverage market.

- Organic growth in RTD tea & iced teas
- Expansion of the culture
- Shift in Market Choice
- Rise of Cultural Creatives

1. **Explosive growth in Ready-to-Drink (RTD) tea and bottled water markets**—Although conventional soft drinks still dominate the beverage market, in the past ten years Ready-to-Drink teas and bottled water have emerged as alternatives. Since 1992 the US tea market has enjoyed 60% annual growth, reaching sales of \$2 billion in 1998. The bottled water market has grown to \$2.4 billion, with most of the growth fueled by sales of single-serving bottles.

1997 U.S. Beverage consumption in billions of gallons*

*Data and Soft Drink Sales figures from Beverage Marketing Inc. The RTD Tea figure is based on 1997 sales estimate of \$2.2 billion, which equates to roughly one billion gallons.

2. **Beyond the tea bag**—The emergence of tea culture—Snapple and similar brands helped create this movement in a broader population. But now, as the culture we find present online, has become popular, consumers are beginning to develop an appreciation for their tea. Over the last ten years U.S. loose leaf tea sales have more than doubled, from \$1.8 billion

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BUSINESS PLAN

End-of-Chapter Learning Portfolio

End-of-chapter materials help students demonstrate a working understanding of key concepts and develop critical-thinking skills.

All chapters include the following:

- **Key Terms** list.
- **Critical Thinking Exercises** that require students to consider important issues and support thoughtful responses.
- **Key Concept Questions** that review core topics.
- **Application Exercises** that give students a structured opportunity to reinforce chapter topics through experience.
- **Exploring Your Community and Exploring Online** assignments that invite students to go into their business communities or search online for information.
- **BizBuilder Business Plan Questions** guide students through the development of business plan components as they learn new information throughout the book.
- **Cases for Analysis** include one short case and one longer case with analytical questions. Cases cover a variety of issues and draw on real business scenarios. Examples of businesses that may be familiar to students include eHarmony, Krispy Kreme, and Khan Academy. Other organizations that may be less familiar include Happy Belly Curbside Kitchen, 23andme, MIDA Trade Ventures, iContact, and Enablemart. These cases reflect a diverse set of entrepreneurs, industries, and geographic locations.

Entrepreneurship Portfolio

Critical Thinking Exercises

- 2-1. What are four positive aspects of franchising for a business start-up? Why are they important?
- 2-2. What are some challenges faced by franchisees?
- 2-3. Describe the type of franchise you might want to open.
- 2-4. Franchisees agree to pay a variety of fees to franchisors, initially and ongoing. Describe these fees, and discuss why understanding their impact on profitability and cash flow is important to franchisees.

Key Concept Questions

- 2-5. Compare and contrast product and trade-name franchising with business-format franchising.
- 2-6. Explain why the FDD is critical to analyzing a franchise opportunity.
- 2-7. What, if any, trends in franchising suggest continued expansion of the industry? Contraction? Cite your sources.

Application Exercise

- 2-8. Identify an industry or type of business that interests you. Select a community where you would like to locate such an organization (select a business that would have a physical presence). Find two competitors already in that market space and one franchisor that is not. Would it or would it not make sense to open a franchise in the community?

Exploring Online

- 2-9. Visit the Wahoo Fish Taco Web site at <http://www.wahoos.com>. What are the advantages of a Wahoo Fish Taco franchise according to the site? What franchise opportunities are available?
- 2-10. Visit the International Franchise Association Web site at <http://www.franchise.org>. Find a franchise organization that is unfamiliar to you. Find the following information about the franchisor:
 - a. When did it begin offering franchisees?
 - b. How many company-owned units does it have?
 - c. What are its initial financial requirements (start-up fee, net worth, liquid resources)?
 - d. What type of franchisor is it (product or trade-name or business-format)?

If the information is not available on the International Franchise Association (IFA) Web site, try others from the list in **Exhibit 2-3**.

Entrepreneurship Portfolio

Critical Thinking Exercises

- 5-1. Use the following charts to define a business you would like to start, and analyze your competitive advantage.

Business Definition Question	Response
The Offer: What products and services will be sold by the business?	
Target Market: Which consumer segments will the business focus on?	
Production Capability: How will that offer be produced and delivered to those customers?	
Problem Solving: What problem does the business solve for its customers?	
Competitive Advantage Question	Competitive Difference (USP)
The Offer: What will be better and different about the products and services that will be sold?	
Target Market: Which segments of consumers should be the focus of the business to make it as successful as possible?	
Production and Delivery Capability: What will be better or different about the way the offer is produced and delivered to those customers?	

Attributes Important to Customers	Weight (a)	Your Company		Competitor Number 1		Competitor Number 2		Competitor Number 3	
		Rating (b)	Weighted Rating (c = a * b)	Rating (d)	Weighted Rating (e = a * d)	Rating (f)	Weighted Rating (g = a * f)	Rating (h)	Weighted Rating (i = a * h)
Quality									
Price									
Location									
Selection									
Service									
Speed/Turnaround									
Specialization									
Personalization									
Total	1.00								

Additional Resources

Instructor Resources

At the Instructor Resource Center, www.pearsonhighered.com/irc, instructors can access a variety of print, digital, and presentation resources available with this text in downloadable format. Registration is simple and gives instructors immediate access to new titles and new editions. As a registered faculty member, you can download resource files and receive immediate access to and instructions for installing course management content on your campus server. In case you ever need assistance, our dedicated technical support team is ready to help with the media supplements that accompany this text. Visit <http://247.pearsoned.com> for answers to frequently asked questions and toll-free user support phone numbers.

The following supplements are available for download to adopting instructors:

- Instructor's Resource Manual
- Test Bank
- TestGen® Computerized Test Bank
- PowerPoint Presentations

Student Resources

BizBuilder Business Plan Worksheets and Templates Online

Go to www.pearsonhighered.com/mariotti to download business plan and presentation templates that will help students write a plan and present it.

- ***BizBuilder Business Plan Worksheets*** provide step-by-step instructions on building a business plan. The MS Word document contains a comprehensive set of questions and tables organized by business plan section. The Excel document includes Start-Up Costs, Sales Projections, Income Statement, Balance Sheet, Cash Flow, and Ratio Analysis worksheets.
- ***BizBuilder Business Plan Template*** provides a professional-looking format for a business plan that ties in with assignments in the text.
- ***BizBuilder Business Plan Presentation Template*** guides the student through the process of creating a PowerPoint presentation deck for a business plan.

Students can build their business plans using the BizBuilder worksheets. Appendix 2 provides students with instructions on how to use the worksheets that mirror the planning process in the book and contains more questions in some areas than are found in commercially available planning software. Once they have created a plan using the worksheets, students can generate a professional-looking document using the BizBuilder Business Plan Template.

CourseSmart eTextbook

CourseSmart eTextbooks were developed for students looking to save on required or recommended textbooks. Students simply select their eText by title or author and purchase immediate access to the content for the duration of the course using any major credit card. With a CourseSmart eText, students can search for specific keywords or page numbers, take notes online, print out reading assignments that incorporate lecture notes, and bookmark important passages for later review. For more information or to purchase a CourseSmart eTextbook, visit www.coursesmart.com.

About the Authors



STEVE MARIOTTI, founder of the Network for Teaching Entrepreneurship (NFTE), is considered one of today's leading experts in education for at-risk youth. He has been helping young people develop marketable skills through learning about entrepreneurship for 30 years.

Starting his career as a treasury analyst for the Ford Motor Company, Mariotti changed career paths in 1982 when he gave up operating his own import-export firm to become a special education teacher in the New York City school system, where he remained for five and a half years. His first assignments were in the East New York and Bedford-Stuyvesant neighborhoods of Brooklyn; he also taught in what was, at the time, the notorious "Fort Apache" neighborhood of the South Bronx.

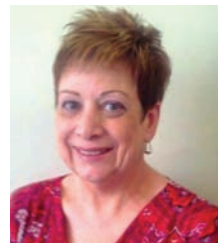
While teaching in these demanding environments, Mariotti gained a breakthrough insight for successfully motivating his economically at-risk students—it was showing them that entrepreneurship, learning how to start and operate their own small businesses, was a way to financial independence. This perception, combined with his solid business background, inspired Mariotti to create a program to bring entrepreneurial education to at-risk young people.

In 1987, the Network for Teaching Entrepreneurship was formed and received nonprofit 501(c)(3) status from the IRS the following year. Now, 25 years later, NFTE continues its mission of bringing entrepreneurship-education programs to youth from low-income communities on a global basis. The organization has reached over half a million young people since its founding and currently has programs and licensees in 18 states, as well as in Belgium, Chile, China, Colombia, Germany, India, Ireland, Israel, and New Zealand.

Steve Mariotti received a B.B.A. and M.B.A. from the University of Michigan, Ann Arbor. He also studied at Harvard University, Stanford University, and Brooklyn College. He has been the subject of many national media profiles, including *ABC Evening News* and *20/20+*. In addition, he is the coauthor of some 20 books and manuals on entrepreneurship that together have sold over one million copies. Mariotti is an active member of the Council on Foreign Relations and has presented papers at the World Economic Forum in Davos.

Among the many honors awarded to Steve Mariotti are Best Teacher of the Year, National Federation of Independent Businesses, 1988; Honorary Doctorate

in Business and Entrepreneurship, Johnson and Wales University, 1990; Social Entrepreneur of the Year, the Chief Executive Officer's Club; *Inc.* Magazine's Social Entrepreneur of the Year Award; Ernst & Young Entrepreneur of the Year Award, 1992; Award from the Minority Business Development Agency of the U.S. Department of Commerce; University of Michigan Business School Entrepreneur of the Year Award; Association of Educational Publishers' Award for Best Math Curriculum, 2010; the Bernard A. Goldhirsh Social Entrepreneur of the Year Award; the New York Enterprise Report's 2012 Founder's Award for Social Entrepreneurship; and 2012 inductee into the Entrepreneurship Hall of Fame.



CAROLINE GLACKIN, Ph.D., is a "pracademic" who has succeeded as a microenterprise and small business owner and manager, as an executive director of a community-development financial institution, and as an academic in areas of community-development

finance, entrepreneurship, and management. She is the Edward L. Snyder Endowed Chair for Business Administration at Shepherd University in West Virginia. She has been assisting entrepreneurs in achieving their dreams for over 30 years.

Glackin earned a doctorate from the University of Delaware, where her research emphasis was on microfinance. She received an M.B.A. from The Wharton School at the University of Pennsylvania and a B.A. from Bryn Mawr College. Her professional career began with the DuPont Company, American Bell, Bell Atlantic, and American Management Systems. She has consulted for businesses and not-for-profit agencies in turnaround and high-growth situations. After exiting a family business, she became the executive director of a Community-Development Financial Institution serving businesses and not-for-profits.

Dr. Glackin has succeeded in leading change in the practical fields of her research and has received numerous honors and awards. These include the first Gloeckner Business Plan Award at The Wharton School, the Minority Business Advocate of the Year for Delaware from the U.S. Small Business Administration, and the She Knows Where She's Going Award from Girls Inc. Dr. Glackin co-chaired the Delaware Governor's Task Force for Financial Independence. She has participated in the Cornell University Emerging Markets Think Tank Series and has presented her research and pedagogy at numerous professional conferences.

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Steve Mariotti

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Caroline Glackin

ENTREPRENEURIAL PATHWAYS

Chapter 1

ENTREPRENEURS RECOGNIZE OPPORTUNITIES

Chapter 2

FRANCHISING

Chapter 3

FINDING OPPORTUNITY IN AN EXISTING BUSINESS

Chapter 4

THE BUSINESS PLAN: ROAD MAP TO SUCCESS



Chapter 1

ENTREPRENEURS RECOGNIZE OPPORTUNITIES

Learning Objectives

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



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

“Everyone lives by selling something.”

—Robert Louis Stevenson,
Scottish author

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

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

Entrepreneurship Defined

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

What Is an Entrepreneur?

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

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

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

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

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

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

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

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

Learning Objective 1

Explain what entrepreneurs do.

¹TerraCycle Inc., accessed June 23, 2013, <http://www.terracycle.net>.

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

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

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

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

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

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

The Economic Questions

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

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

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

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

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

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

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

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

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

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

Voluntary Exchange

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

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

Benefits and Challenges of Free Enterprise

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

Learning Objective 2

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

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

capital money or property owned or used in business.

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

Global Impact . . .

Free Trade

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

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

Where entrepreneurs are free to trade voluntarily, to as large a market as possible, their ability to find customers to buy

their goods or services increases, as well as their overall ability to meet consumer needs. Meanwhile, the Internet has made it much easier for businesses to sell to clients all over the world. Shipping, too, has become much faster and less expensive.

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

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

What Is a Small Business?

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

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

Why Become an Entrepreneur?

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

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

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

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

BizFacts

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

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

3. **Creation/ownership.** Entrepreneurship is a creative endeavor.

Entrepreneurs put time and effort into creating a venture that they expect will survive and become profitable. Entrepreneurs own the businesses they create and the profits those businesses earn.

Ownership is the key to wealth. Your goal is to find a business that will create a continuing stream of earnings. Eventually, you may be able to sell that company for a multiple of those earnings. That is how entrepreneurs create wealth. Many entrepreneurs, such as Bill Gore, the inventor of GORE-TEX fabric, start their own business after becoming frustrated or disillusioned in other roles or having ideas rejected by an employer.

4. **Control over compensation.** Entrepreneurs choose how and when they are paid. As owner of your company, when funds permit, you can decide to:

- Pay yourself a **salary**—a fixed payment made at regular intervals, such as every week or every month. Salaries are not applicable to sole proprietorships, where owners may take a “draw” on revenues, or partnerships, where they may “draw down” profits.
- Pay yourself a **wage**—a fixed rate per hour. This is not a common choice, but it is available.
- Take a share of the company's profit. As the owner, you can pay yourself a portion of the business's profits. In a corporation this kind of payment is called a **dividend** and must be paid to all shareholders.
- Take a **commission** on every sale you make. A commission is a percentage of the value of a sale. If you decide to pay yourself 10 percent commission, and sell an item for \$120, your commission on the sale would be \$12.

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

wage fixed payment per hour for work performed.

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

commission a percentage of a sale paid to a salesperson.

5. **Control over working conditions.** As an entrepreneur, you can create a work environment that reflects your values. If you support recycling, you can make sure your company recycles. You will also evaluate your own performance. As long as you have control of the company, no one else has the power to fire you. If equality is essential, you may have an office with equal working spaces, no special privileges for managers, and few management layers.

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



Jeff Greenberg/Alamy

O'Lakes, Florida, with hundreds of independent contractors who are balloon artists. Alexander, who started the company in 2003, secures contracts with restaurants to provide balloon artists to amuse customers while they wait to be seated or while they are seated and waiting for their food to be served.

Step into the Shoes . . .

Balloon Distractions Inc.: Putting a New Twist on Entertainment

When Ben Alexander was a student at Rowan University in Glassboro, New Jersey, he earned spending money by working as a balloon artist. Today, he operates Balloon Distractions in Land

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

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

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

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

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

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

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

Definitions of Success—Monetary and Other

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

³Virgin Group, accessed June 26, 2013, <http://www.virgin.com>.

⁴“The World's Billionaires,” *Forbes*, March 2013, accessed June 26, 2013, <http://www.forbes.com>.

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

Taking the Long View

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

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

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

Benefits and Costs of Becoming an Entrepreneur

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

Benefits include:

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