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20th Edition

SMALL BUSINESS MANAGEMENT

Launching & Growing
Entrepreneurial Ventures

Longenecker • Petty • Palich • Hoy



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Brief Contents



Part 1	Entrepreneurship: A World of Opportunity	
	1 The Entrepreneurial Life	1
	2 Integrity, Ethics, and Social Entrepreneurship	28
Part 2	Starting from Scratch or Joining an Existing Business	
	3 Starting a Small Business	57
	4 Franchises and Independent Contracting in the Gig and Sharing Economies	91
	5 The Family Business and Buyouts	113
Part 3	Developing the New Venture Business Plan	
	6 Visualizing Your Dream: The Business Model and the Business Plan	138
	7 The Marketing Plan	163
	8 The Organizational Plan: Teams, Legal Structures, Alliances, and Directors	184
	9 The Location Plan	217
	10 Understanding a Firm's Financial Statements	249
	11 Forecasting Financial Requirements	276
	12 Financing the Small Business	301
	13 Planning for the Harvest	332
Part 4	Focusing on the Customer: Marketing Growth Strategies	
	14 Building Customer Relationships	352
	15 Product Development and Supply Chain Management	384
	16 Pricing and Credit Decisions	417
	17 Promotional Planning	441
	18 Global Opportunities for Small Businesses	467
Part 5	Managing Growth in the Small Business	
	19 Professional Management and the Small Business	499
	20 Managing Human Resources	531
	21 Managing Small Business Operations	567
	22 Managing the Firm's Assets	601
	23 Managing Risk	627
	Cases/Video Cases	649
	Index	702

Contents



Part 1 Entrepreneurship: A World of Opportunity

Chapter 1 The Entrepreneurial Life

Spotlight on Small Business: Energy Solutions of Texas

1-1	Small Size, Big Significance	3
1-2	Small Business and Entrepreneurship	4
1-2a	What Is a Small Business?	4
	<i>Living the Dream</i> Always Go the Extra Mile	5
1-2b	What Is Entrepreneurship?	6
	<i>Living the Dream</i> Pursuing Your Calling	9
	<i>Living the Dream</i> Don't Let Challenges Stand in Your Way	11
1-3	Can a Small Company Really Compete with Big Companies?	12
1-3a	Commitment to Integrity	12
1-3b	Customer Focus	12
1-3c	Quality Performance	12
	<i>Living the Dream</i> If You See a Problem, Fix It	13
1-3d	Innovation	13
1-3e	Niche Markets	14
1-4	Motivations for Owning a Business	14
1-4a	Types of Entrepreneurial Motivations	14
1-4b	Influencers of the Decision to Own a Business	18
1-4c	Why Your Perceptions Matter	18
1-5	What Do You Want Your Legacy to Be? Ready to Begin?	21

Chapter 2 Integrity, Ethics, and Social Entrepreneurship

2	<i>Spotlight on Small Business: Bambino's Frozen Baby Food</i>	28
2-1	What is Integrity?	29
2-2	Integrity and the Interests of Major Stakeholders	30
2-2a	The “Big Three” Stakeholders—Owners, Customers, and Employees	31
2-2b	Social Responsibility and Small Business	32
2-2c	Integrity and Governmental Regulations	34
	<i>Living the Dream</i> An Entrepreneur Who Leads with Heart	35
2-3	The Challenges and Benefits of Acting with Integrity	36
2-3a	Small Companies and the Legitimacy Lie	37
2-3b	Integrity Online	37
2-3c	Integrity and Doing Business Abroad	39
2-3d	The Integrity Edge	41
2-4	Building a Business with Integrity	41
2-4a	The Foundations of Integrity	42
2-4b	Leading with Integrity	42
2-4c	An Ethical Organizational Culture	43
2-4d	Better Business Bureaus	43
2-4e	The Ethical Decision-Making Process	44
2-5	Social Entrepreneurship: A Continuing Trend	45
2-5a	Social Entrepreneurship and the Triple Bottom Line	47
2-5b	Small Business and the Natural Environment	47
	<i>Living the Dream</i> Don't Let Your Landscaper Get Your Goat!	48

Part 2

Starting from Scratch or Joining an Existing Business

Chapter 3 Starting a Small Business 57

Spotlight on Small Business: HARA Clean Beauty 58

3-1	Developing Start-Up Ideas	59
3-1a	Types of Start-Up Ideas	60
3-1b	Common Sources of Start-Up Ideas	61
3-2	Using Innovative Thinking to Identify Business Ideas	63
3-2a	Identify “Pain Points” That Open the Door to New Possibilities	63
3-2b	Take a Cue from Existing Products or Services	63
3-2c	Find New Ways to Deliver Products and Services	65
3-2d	Tap into the Potential of Emerging Possibilities	67
	<i>Living the Dream</i> More and More Entrepreneurs Are Joining the Club	68
3-3	Using Internal and External Analyses to Assess New Business Ideas	69
3-3a	Outside-In Analysis	69
	<i>Living the Dream</i> Delivering on Promises during a Pandemic	73
3-3b	Inside-Out Analysis	74
3-3c	Integrating Internal and External Analyses	75
3-4	Selecting Strategies That Capture Opportunities	77
3-4a	Broad-Based Strategy Options	77
3-4b	Focus Strategies	78
3-5	Screening New Business Ideas	79
3-6	Is Your Start-Up Idea Feasible?	81
3-6a	Market Potential	82
3-6b	Industry Attractiveness	84
3-6c	New Venture Leadership	84

Chapter 4 Franchises and Independent Contracting in the Gig and Sharing Economies 91

Spotlight on Small Business: Duck Donuts 92

4-1	What Is a Franchise?	93
4-1a	Franchising Terminology	93
4-1b	The Impact of Franchising	94
4-2	The Pros and Cons of Franchising	95
4-2a	The Pros of Franchising	95
4-2b	The Cons of Franchising	96
4-2c	The Costs of Being a Franchisee	97
4-3	Evaluating Franchise Opportunities	98
4-3a	Selecting a Franchise	98
4-3b	Investigating the Potential Franchise	98

4-3c	Becoming a Franchisor	99
	<i>Living the Dream</i> Building a Business and Opening the Door for Others	100
4-3d	Legal Issues in Franchising	101
4-4	Independent Contracting in the Gig and Sharing Economies	103
4-4a	Defining Independent Contractors	103
4-4b	Defining the Gig and Sharing Economies	104
	<i>Living the Dream</i> College Students in the Gig and Sharing Economies	105
4-4c	Independent Contracting versus Employment	107
4-4d	The Future of the Gig and Sharing Economies	107

Chapter 5 The Family Business and Buyouts 113

Spotlight on Small Business: Dietz & Watson 114

5-1	What Is a Family Business?	115
5-1a	Family and Business Overlap	116
5-1b	Advantages and Disadvantages of a Family Business	117
5-2	Family Roles and Relationships	118
5-2a	Co-preneurs	118
5-2b	Parents as Founders	118
5-2c	Children	119
5-2d	Sibling Cooperation, Sibling Rivalry	119
	<i>Living the Dream</i> A Sweet Sibling Success Story	120
5-2e	In-Laws In and Out of the Business	121
5-2f	The Entrepreneur’s Partner	122
5-3	Good Governance in the Family Business	122
5-3a	Nonfamily Employees in a Family Firm	122
5-3b	Family Retreats	123
5-3c	Family Councils	124
5-3d	Family Business Constitutions	124
5-4	Management and Ownership Succession	125
5-4a	Available Family Talent	125
5-4b	Preparing for Succession	125
5-4c	Transfer of Ownership	126
5-5	Buying an Existing Business	127
5-5a	Reasons for Buying an Existing Business	127
	<i>Living the Dream</i> Buying an Existing Business to Satisfy the Need for Independence	128
5-5b	Finding a Business to Buy	129
5-5c	Investigating and Evaluating Available Businesses	130
5-5d	Quantitative Factors in Valuing a Business	131
5-5e	Nonquantitative Factors in Valuing a Business	131
5-5f	Negotiating and Closing the Deal	132

Part 3

Developing the New Venture Business Plan

Chapter 6 Visualizing Your Dream: The Business Model and the Business Plan

138

Spotlight on Small Business: Maternova 139

6-1	The Business Model and the Entrepreneur	140
6-1a	What Is a Business Model?	140
6-1b	Creating a Business Model	140
6-2	Think Lean Start-up	144
6-3	The Purpose and Form of a Business Plan	144
6-3a	What Is a Business Plan?	144
6-3b	Who Cares about the Business Plan?	145
6-3c	Execution Matters	146
6-3d	What Form Will the Business Plan Take?	146
	<i>Living the Dream</i> Jania and Desmin Daniels Believe in Writing a Business Plan	147
6-4	Preparing a Business Plan: Content, Format, and Quality	148
6-4a	Cover Page	148
6-4b	Table of Contents	149
6-4c	Executive Summary (Overview)	150
6-4d	Company Description	150
6-4e	Industry, Target Customer, and Competitor Analysis	151
6-4f	Product/Service Plan	151
6-4g	Marketing Plan	151
6-4h	Operations and Development Plan	152
6-4i	Management Team Section	152
6-4j	Critical Risks Section	152
6-4k	Offering	153
6-4l	Exit Strategy	153
6-4m	Financial Plan	154
6-4n	Appendix of Supporting Documents	154
6-5	Writing a Business Plan	155
6-5a	Analyze the Market Thoroughly	155
6-5b	Recognize Your Competition	155
6-5c	Provide Solid Evidence for Any Claims	155
6-5d	Think Like an Investor	155
6-5e	Identify Potential Fatal Flaws	156
6-5f	Pay Attention to Details	156
	<i>Living the Dream</i> Writing a Sweet Business Plan	157
6-6	Pitching to Investors	158

Chapter 7 The Marketing Plan

163

Spotlight on Small Business: Barry Moltz 164

7-1	What Is Small Business Marketing?	165
7-1a	Having a Marketing Orientation Makes a Difference	165
7-1b	Choosing a Consumer Approach	166

7-2	The Formal Marketing Plan	166
7-2a	Goals	166
7-2b	Value Propositions	167
7-2c	Competition	167
7-2d	Customer Segments	168
7-2e	Marketing Strategy	168
	<i>Living the Dream</i> Promoting a Blissful Product	170
7-2f	Metrics	172
7-3	Understanding Potential Target Markets	173
7-3a	Market Segmentation and Its Variables	173
7-3b	Marketing Strategies Based on Segmentation Considerations	174
7-4	Finding Customers	175
7-4a	Matching Value Propositions to Customer Segments	175
	<i>Living the Dream</i> Building a Strong Network	177
7-4b	Continuously Improving the Marketing Plan through Feedback	177
7-5	Estimating Market Potential	179
7-5a	The Sales Forecast	179
7-5b	Limitations of Forecasting	179

Chapter 8 The Organizational Plan: Teams, Legal Structures, Alliances, and Directors

184

Spotlight on Small Business: Bubbakoo's Burritos 185

8-1	Building a Management Team	186
8-1a	Achieving Balance	187
8-1b	The Solo Start-up Is Still an Option	188
8-1c	Expanding Social Networks	188
	<i>Living the Dream</i> When the Start-Up Game Is Best Played as a Team Sport	189
8-2	Common Legal Forms of Organization	191
8-2a	The Sole Proprietorship Option	191
8-2b	The Partnership Option	193
8-2c	The C Corporation Option	196
8-3	Considerations in Choosing an Organizational Form	197
8-3a	Initial Organizational Requirements and Costs	198
8-3b	Liability of Owners	198
8-3c	Continuity of Business	199
8-3d	Transferability of Ownership	199
8-3e	Management Control	200
8-3f	Attractiveness for Raising Capital	200
8-3g	Income Taxes	200
8-4	Specialized Legal Forms of Organization	201
8-4a	The Limited Partnership	201
8-4b	The S Corporation	201

8-4c	The Limited Liability Company	201	10-2	The Balance Sheet	257
8-4d	The Professional Corporation	202		<i>Living the Dream</i> Avoiding the Path to Failure	258
8-4e	The Nonprofit Corporation	202	10-2a	An Overview of the Balance Sheet	258
8-4f	The Benefit Corporation	203	10-2b	ACE, Inc.: The Balance Sheet Illustrated	262
8-5	Forming Strategic Alliances	204	10-3	The Statement of Cash Flows	263
8-5a	Strategic Alliances with Large Companies	204		<i>Living the Dream</i> Understand Your Numbers, and Take Important Relationships with You	264
8-5b	Strategic Alliances with Small Companies	205	10-3a	Profits versus Cash Flows	265
8-5c	Setting up and Maintaining Successful Strategic Alliances	206	10-3b	An Overview of Measuring a Firm's Cash Flows	265
8-6	Making the Most of a Board of Directors	207	10-3c	ACE, Inc.: Statement of Cash Flows Illustrated	266
8-6a	Selection of Directors	207	10-4	Evaluating a Firm's Financial Position	268
8-6b	Contributions of Directors	208	10-4a	Analyzing Financial Statements: An Overview	268
8-6c	Compensation of Directors	209	10-4b	ACE, Inc.: Financial Position Analysis Illustrated	269
8-6d	An Alternative: An Advisory Board	209			
Chapter 9 The Location Plan		217	Chapter 11 Forecasting Financial Requirements		276
	<i>Spotlight on Small Business: On Location Tours</i>	218		<i>Spotlight on Small Business: The Big Smoke</i>	277
9-1	Locating the Start-up in a Traditional Physical Facility	219	11-1	The Purpose of Financial Forecasting	277
9-1a	The Importance of the Location Decision	220	11-2	Forecasting Profitability	278
9-1b	Key Factors in Selecting a Good Location	220	11-2a	An Overview of Forecasting Profitability	278
9-2	Designing and Equipping the Physical Facility	226	11-2b	D&R Products, Inc.: Forecasting Profitability Illustrated	279
9-2a	Challenges in Designing the Physical Facility	226	11-3	Forecasting Asset and Financing Requirements	282
9-2b	Challenges in Equipping the Physical Facility	227		<i>Living the Dream</i> Financial Planning Makes a Difference at REEcycle	283
9-2c	Business Image	229	11-3a	An Overview of Determining Asset Requirements	285
9-3	Locating the Start-up in the Entrepreneur's Home	229	11-3b	D&R Products, Inc.: Determining Asset Requirements Illustrated	286
	<i>Living the Dream</i> There's Something Fishy about This Home-Based Business	230	11-3c	An Overview of Determining Financing Requirements	287
9-3a	The Attraction of Home-Based Businesses	231	11-3d	D&R Products, Inc.: Determining Financing Requirements Illustrated	288
9-3b	The Challenges of Home-Based Businesses	232	11-4	Forecasting Cash Flows	291
9-4	E-Commerce: Locating a Start-up Online	233	11-4a	An Overview of Forecasting Cash Flows	291
9-4a	Benefits of E-Commerce for Start-ups	233	11-4b	D&R Products, Inc.: Forecasting Cash Flows Illustrated	292
9-4b	E-Commerce Business Models	234	11-4c	An Overview of the Cash Budget	293
	<i>Living the Dream</i> Getting Fired Up about Podcasting	241	11-4d	D&R Products, Inc.: The Cash Budget Illustrated	293
9-4c	Online Businesses and the Part-Time Start-up Advantage	242	11-5	Use Good Judgment When Forecasting	295
Chapter 10 Understanding a Firm's Financial Statements		249	Chapter 12 Financing the Small Business		301
	<i>Spotlight on Small Business: G&P Properties</i>	250		<i>Spotlight on Small Business: Ready, Set, Food!</i>	302
	The Lemonade Kids	250	12-1	Firm Characteristics and Sources of Financing	303
	Setting Up the Business	251	12-1a	A Firm's Economic Potential	304
	The First Saturday	252	12-1b	Company Size and Maturity	304
	Collecting Accounts Receivable	253	12-1c	The Nature of a Firm's Assets	304
	Planning for the Next Saturday	253	12-1d	Owner Preferences for Debt or Equity	304
	The Second Saturday of Business	254	12-2	Choosing Between Debt and Equity Financing	305
10-1	The Income Statement	254	12-2a	Potential Profitability	305
10-1a	An Overview of the Income Statement	254	12-2b	Financial Risk	307
10-1b	ACE, Inc.: The Income Statement Illustrated	255	12-2c	Voting Control	308

12-3 Sources of Small Business Financing: The Starting Point	309	12-9 Additional Sources of Financing	326
12-3a Personal Savings	310	12-9a Large Corporations	326
12-3b Friends and Family	311	12-9b Stock Sales	326
12-3c Credit Cards	311		
12-4 Bank Financing	312	Chapter 13 Planning for the Harvest	332
12-4a Types of Bank Loans	312	<i>Spotlight on Small Business: Will There Still Be Life after Selling Your Business?</i>	333
12-4b Understanding a Banker's Perspective	313	13-1 The Importance of the Harvest	334
12-4c A Banker's Information Requirements	314	13-2 Methods of Harvesting a Business	335
12-4d Selecting a Banker	316	13-2a Selling the Firm	335
12-4e Negotiating the Loan	316	13-2b Distributing the Firm's Cash Flows	339
12-5 Business Suppliers and Asset-Based Lenders	318	13-2c Conducting an Initial Public Offering (IPO)	339
12-5a Accounts Payable (Trade Credit)	318	<i>Living the Dream</i> Finishing Well	340
12-5b Equipment Loans and Leases	318	13-2d Private Equity Recapitalization	342
12-5c Asset-Based Lending	319	13-3 Firm Valuation and Payment Methods	343
12-6 Private Equity Investors	320	13-3a The Harvest Value	343
12-6a Business Angels	320	13-3b The Method of Payment	344
12-6b Venture Capital Firms	321	13-4 Developing an Effective Harvest Plan	344
<i>Living the Dream</i> Collaborative Lending	322	13-4a Anticipate the Harvest	344
12-7 Crowdfunding	323	13-4b Expect Conflict—Emotional and Cultural	345
12-8 Government Loan Programs	324	13-4c Get Good Advice	346
12-8a The Small Business Administration	324	13-4d Understand What Motivates You	346
12-8b State and Local Government Assistance	325	13-4e What's Next?	347
12-8c Community-Based Financial Institutions	326		

Part 4

Focusing on the Customer: Marketing Growth Strategies

Chapter 14 Building Customer Relationships	352	14-4 Customers as Decision Makers	369
<i>Spotlight on Small Business: Jimyz Automotive</i>	353	14-4a Need Recognition	370
14-1 What Is Customer Relationship Management?	354	14-4b Information Search and Evaluation	370
14-1a Benefits of CRM to a Small Firm	355	<i>Living the Dream</i> Thriving during a Pandemic, Naturally	371
14-1b Essential Materials for a CRM Program	355	14-4c Purchase Decision	372
14-2 Outstanding Customer Relationships through Extraordinary Service	356	14-4d Post-Purchase Evaluation	372
14-2a Managing Customer Satisfaction	356	14-5 Understanding Psychological Influences on Customer Behavior	374
<i>Living the Dream</i> Excellent Customer Service Can Be a Calling	359	14-5a Needs	374
14-2b Evaluating a Firm's Customer Service Health	360	14-5b Perceptions	374
14-3 Using Technology to Support Customer Relationship Management	363	14-5c Motivations	375
14-3a Choosing a CRM Software Program	363	14-5d Attitudes	375
14-3b Choosing an Alternative CRM System	364	14-6 Understanding Sociological Influences on Customer Behavior	375
14-3c Creating a Customer Database	366	14-6a Cultures	376
14-3d Using a Customer Database	367	14-6b Social Classes	376
14-3e Data Use and Privacy Concerns	368	14-6c Reference Groups	376
		14-6d Opinion Leaders	377

Chapter 15 Product Development and Supply Chain Management	384		
<i>Spotlight on Small Business: Chillhouse</i>	385		
15-1 To Grow or Not to Grow	386		
15-2 Innovation: A Path to Growth	388		
15-2a Gaining a Competitive Advantage	388		
15-2b Achieving Sustainability	389		
<i>Living the Dream</i> Business for Dummies	391		
15-3 The Product Life Cycle and New Product Development	392		
15-3a The Product Life Cycle	392		
15-3b The New Product Development Process	393		
15-4 Building the Total Product	396		
15-4a Branding	396		
15-4b Packaging	399		
15-4c Labeling	400		
15-4d Warranties	400		
15-5 Product Strategy	400		
15-5a Product Marketing versus Service Marketing	401		
15-5b Product Strategy Options	402		
15-6 The Legal Environment	403		
15-6a Consumer Protection	403		
15-6b Protection of Intellectual Property	404		
15-7 Supply Chain Management	406		
15-7a Intermediaries	407		
15-7b Channels of Distribution	407		
<i>Living the Dream</i> “Meating” the Specific Needs of Customers	409		
15-7c The Scope of Physical Distribution	410		
Chapter 16 Pricing and Credit Decisions	417		
<i>Spotlight on Small Business: The Barefoot Spirit</i>	418		
16-1 Setting a Price	419		
16-1a Know the Costs When Setting Your Prices	420		
16-1b Pricing Starting with Customers	421		
<i>Living the Dream</i> You Can Have My Business Plan!	422		
16-2 Applying a Pricing System	423		
16-2a Break-Even Analysis	423		
16-2b Markup Pricing	425		
16-3 Selecting a Pricing Strategy	426		
16-3a Penetration Pricing	427		
16-3b Price Skimming	427		
16-3c Follow-the-Leader Pricing	427		
16-3d Variable Pricing	428		
16-3e Price Lining	428		
16-3f Optional Product and Service Pricing	428		
<i>Living the Dream</i> Pricing to Grow	429		
16-4 Offering Credit	429		
16-4a Benefits of Credit	430		
16-4b Factors That Affect Selling on Credit	430		
16-4c Types of Credit	431		
16-5 Managing the Credit Process	433		
16-5a Evaluation of Credit Applicants	433		
16-5b Sources of Credit Information	434		
16-5c Aging of Accounts Receivable	435		
16-5d Billing and Collection Procedures	436		
16-5e Credit Regulation	437		
Chapter 17 Promotional Planning	441		
<i>Spotlight on Small Business: The Dyrtr</i>	442		
17-1 Promotion Is Communication	443		
17-1a The Promotional Mix	443		
17-1b The Costs of Promotion	444		
17-1c Promoting the Characteristics of Products or Services	444		
17-1d Learning from Competitors	444		
17-1e Listening to Customers	444		
17-2 Determining the Promotional Budget	445		
17-2a Budgeting a Fixed Percentage of Sales	445		
17-2b Spending Whatever Is Left Over	445		
17-2c Spending at the Same Level as Competitors	445		
17-2d Determining How Much Is Needed to Achieve Objectives	446		
17-3 Promotion Using Websites and Social Media	446		
17-3a The Small Business Website	446		
17-3b Social Media	448		
17-3c Additional Ways to Promote Your Product or Service on the Internet	448		
17-4 Personal Selling in the Small Firm	451		
<i>Living the Dream</i> Matching the Salesperson to the Customer	452		
17-4a The Importance of Product Knowledge	452		
17-4b The Sales Presentation	452		
17-4c Cost Control in Personal Selling	454		
17-4d The Compensation of Salespeople	455		
17-5 Advertising Practices	456		
17-5a Advertising Objectives	456		
17-5b Types of Advertising	456		
17-5c Advertising Specialists	457		
17-5d Frequency of Advertising	457		
17-5e Where to Advertise	458		
<i>Living the Dream</i> Playing Games and Watching Ads	459		
17-6 Sales Promotion	459		
17-6a Specialties	460		
17-6b Trade Show Exhibits	460		
17-6c Coupons	461		
17-6d Publicity	461		
17-6e When to Use Sales Promotion	462		

Chapter 18 Global Opportunities for Small Businesses

467

Spotlight on Small Business: CrateBind 468

18-1	Small Businesses as Global Enterprises	469
18-2	The Primary Forces Driving Global Businesses	471
18-2a	Expanding Markets	472
18-2b	Gaining Access to Resources	474
18-2c	Cutting Costs	475
18-2d	Capitalizing on Special Features of Location	477
18-3	Strategy Options for Global Firms	478
18-3a	Exporting	478
18-3b	Importing	480
18-3c	Foreign Licensing	481

<i>Living the Dream</i>	Importing Satisfaction to New Yorkers with a Taste for Authentic Asian Veggies	482
18-3d	International Franchising	483
<i>Living the Dream</i>	A Small Company That Refused to Get Mugged by Counterfeiters	484
18-3e	International Strategic Alliances	485
18-3f	Locating Facilities Abroad	486
18-4	Challenges to Global Businesses	487
18-4a	Political Risk	487
18-4b	Economic Risk	487
18-4c	The Ease of Doing Business Index	488
18-5	Assistance for Global Enterprises	489
18-5a	Analyzing Markets and Planning Strategy	489
18-5b	Connecting with International Customers	490
18-5c	Financing for Small Global Enterprises	492

Part 5 Managing Growth in the Small Business

Chapter 19 Professional Management and the Small Business

499

Spotlight on Small Business: Learning to Lead at ASRV Sportswear 500

19-1	Small Business Leadership	501
19-1a	What Is Leadership?	501
19-1b	Leadership Qualities of Founders	501
19-1c	What Makes a Leader Effective?	502
19-1d	Leadership Styles	503
19-1e	Shaping the Culture of the Organization	504
19-2	The Small Firm Management Process	506
19-2a	From Founder to Professional Manager	506
19-2b	Firm Growth and Managerial Practices	508
19-3	Managerial Responsibilities of Entrepreneurs	510
19-3a	Planning Activities	510
19-3b	Creating an Organizational Structure	511
19-3c	Delegating Authority	512
<i>Living the Dream</i>	You May Not Be the Best “You” After All: Charlie Chaplin	514
19-3d	Controlling Operations	515
19-3e	Communicating Effectively	515
	Communication Tools	516
19-3f	Negotiating	517
19-4	Personal Time Management	519
19-4a	The Problem of Time Pressure	519
19-4b	Time Savers for Busy Managers	519
19-5	Outside Management Assistance	521
19-5a	The Need for Outside Assistance	521
19-5b	Sources of Management Assistance	522

<i>Living the Dream</i>	When You’re Doggin’ It in the Game of Small Business, It’s Important to SCORE	523
-------------------------	---	-----

Chapter 20 Managing Human Resources

531

Spotlight on Small Business: Kitu Life, Inc. 532

20-1	Recruiting Personnel	533
20-1a	The Need for Quality Employees	534
20-1b	The Lure of Entrepreneurial Firms	534
<i>Living the Dream</i>	What to Do When a Bad-Fruit Start-Up Runs Out of Juice	536
20-1c	Sources of Employees	537
20-1d	Diversity in the Workforce	540
20-1e	Job Descriptions	541
20-2	Evaluating Prospects and Selecting Employees	542
20-2a	Step 1: Use Application Forms	542
20-2b	Step 2: Interview the Applicants	542
20-2c	Step 3: Check References and Other Background Information	544
20-2d	Step 4: Test the Applicants	546
20-2e	Step 5: Require Physical Examinations	546
20-3	Training and Developing Employees	547
20-3a	Basic Components of Training and Development	547
20-3b	Orientation for New Personnel	548
20-3c	Employee Training	548
20-3d	From Training to Implementation	550
20-3e	Development of Managerial and Professional Employees	551

20-4 Compensation and Incentives for Employees	552	Chapter 22 Managing the Firm's Assets	601
20-4a Wage and Salary Levels	552	<i>Spotlight on Small Business: Nathan Perry, founder, Cutting Edge Elite, Inc.</i>	602
20-4b Financial Incentives	553	22-1 The Working Capital Cycle	603
20-4c Stock Incentives	553	22-1a The Timing and Size of Working Capital Investments	604
20-4d Employee Benefits	554	22-1b Examples of Working Capital Management	605
<i>Living the Dream</i> Sorry Charlie, Your Unlimited Vacation Plans Have Been Canceled	555	22-2 Managing Cash Flows	610
20-5 Special Issues in Human Resource Management	556	22-3 Managing Accounts Receivable	611
20-5a Co-Employment Agreements	556	22-3a How Accounts Receivable Affect Cash	611
20-5b Legal Protection of Employees	557	22-3b The Life Cycle of Accounts Receivable	611
20-5c Labor Unions	559	22-3c Accounts Receivable Financing	613
20-5d Formalizing Employer–Employee Relationships	559	22-4 Managing Inventory	614
20-5e The Need for a Human Resource Manager	560	22-4a Reducing Inventory to Free Cash	614
		22-4b Monitoring Inventory	614
		22-4c Controlling Stockpiles	615
		<i>Living the Dream</i> Taking Stock of Inventory Management	615
		22-5 Managing Accounts Payable	616
		22-6 Cash Conversion Period Revisited	617
		22-7 Capital Budgeting Techniques	618
		22-7a Accounting Return on Investment	619
		22-7b Payback Period	620
		22-7c Discounted Cash Flows	620
		22-8 Capital Budgeting Practices in Small Firms	621
Chapter 21 Managing Small Business Operations	567	Chapter 23 Managing Risk	627
<i>Spotlight on Small Business: Roscoe Village Bikes</i>	568	<i>Spotlight on Small Business: Collin Street Bakery</i>	628
21-1 Competing with Operations	569	23-1 What Is Business Risk?	629
21-2 The Operations Process	570	23-2 Basic Types of Pure Risk	629
21-2a The Operations Process in a Service Business	570	23-2a Property Risks	629
21-2b The Operations Process in a Manufacturing Business	572	23-2b Liability Risks	630
21-2c Capacity Considerations	573	23-2c Personnel Risks	634
21-2d Planning and Scheduling	573	23-3 Risk Management	635
<i>Living the Dream</i> Some Employees Always Have a Chip on Their Shoulders—Or in Their Bellies	574	23-3a The Process of Risk Management	635
21-3 Inventory Management and Operations	575	23-3b Risk Management in the Small Business	636
21-3a Objectives of Inventory Management	576	23-4 Basic Principles of a Sound Insurance Program	638
21-3b Inventory Cost Control	577	23-5 Common Types of Business Insurance	638
21-3c Inventory Recordkeeping Systems	579	23-5a Property and Casualty Insurance	638
21-4 Quality and Operations Management	579	<i>Living the Dream</i> Duffy Group	642
21-4a Quality as a Competitive Tool	579	23-5b Life and Health Insurance	643
21-4b The Customer Focus of Quality Management	581	<i>Living the Dream</i> Ten Security Tips for Small Businesses	644
21-4c “The Basic Seven” Quality Tools	583		
21-4d Quality Inspection Versus Poka-Yoke	584		
21-4e Statistical Methods of Quality Control	584		
21-4f International Certification for Quality Management	585		
21-4g Quality Management in Service Businesses	586		
21-5 Purchasing Policies and Practices	586		
21-5a The Importance of Purchasing	586		
21-5b Measuring Supplier Performance	589		
21-5c Building Good Relationships with Suppliers	590		
21-5d Forming Strategic Alliances	590		
21-5e Forecasting Supply Needs	591		
21-5f Using Information Systems	591		
21-6 Lean Production and Synchronous Management	592		
21-6a Lean Production	592		
21-6b Synchronous Management	593		
<i>Living the Dream</i> Some Small Business Problems Can Be Cutting!	594		
		Cases/Video Cases	649
		Index	702

Preface



I didn't realize how hard it was to run a small business.

**—Andrew Mason,
former CEO of Groupon**

Andrew Mason, the founder of Groupon, is featured in the case for Chapter 19. Even though Mason created the company, he was eventually fired by the board. He clearly had a creative idea but discovered too late that building and running a successful business requires more than having a good idea. This concept, along with many others, will be explored in more depth throughout this latest edition of *Small Business Management: Launching and Growing Entrepreneurial Ventures*.

We welcome you to the 20th edition of *Small Business Management: Launching and Growing Entrepreneurial Ventures*. At its core, *Small Business Management* is organized to help students and future entrepreneurs achieve success in whatever field they choose. The wide spectrum of content, applications, cases, graphics, stories, and other details offered in *Small Business Management* has assisted many small business entrepreneurs in making their dreams come true. With a focus on learning, our features emphasize activities that capture student interest and guarantee practical knowledge.

In 1964, Halsey Broom and Justin Longenecker wrote the first edition of *Small Business Management: Launching and Growing Entrepreneurial Ventures*. As colleagues at Baylor University, they discovered that they shared a passion for teaching students about the importance and the opportunities provided from owning their own businesses.

At that time, courses in entrepreneurship and small business management were almost nonexistent. In those days, business curricu-

lums at practically all colleges and universities taught students only how to work for someone else. But Broom and Longenecker believed there was another alternative, and a good one, for students to achieve their professional goals through owning a business of their own. They contended that owning a business was a way to make life better for others, while building wealth for themselves, and at the same time providing a way to give back to their communities.

From that small beginning in 1964, *Small Business Management* is now in its 20th edition. Few textbooks survive even three editions, much less 20! By 2022, we estimate that some 3 million readers who aspire to become entrepreneurs have benefited from the book. From our knowledge, no other small business management textbook has even come close to this number of readers. Also, we are aware that many students have chosen to keep *Small Business Management*, rather than sell it at the end of a semester, making the book a part of their permanent library. As one student explained, “*Small Business Management* is one of the few books from my college days that I have kept for future reference.” This comment is representative of countless other similar remarks that students have made over the years after having read and studied the book for class. Looking back, we can see that these two college professors were ahead of their time.

Why has *Small Business Management* continued to be a leader in preparing students to own their own small businesses for nearly six decades now? We believe there are a number of reasons, a few being:

- Most importantly, the *Small Business Management* author team over the years have never become complacent. We have continued to live the dream started by Broom and Longenecker. As they did, we believe that what we are doing matters in the lives of our readers. It is about more than just presenting facts and figures—so much more. It is about life itself.
- Our **Integrated Learning System** uses each chapter’s learning objectives to give structure and coherence to the text content, study aids, and instructor’s ancillaries, all of which are keyed to these objectives.
- *Small Business Management* provides instruction and guidance that will greatly improve your odds for success as you take your own entrepreneurial journey. We continue to present the best information available today about launching and growing small businesses.
- Examples throughout the textbook demonstrate that there is not a single path to success. The goal is to help you find one that will work best for you.
- We emphasize the importance of building relationships along the way. Even if you are the company’s only employee, you still have relationships with and depend on others, including your family, a banker, suppliers, and customers. To succeed you must be effective in your relationships with other people. The bottom line: You cannot accomplish anything of any significance by yourself!
- Many readers of *Small Business Management* have limited training and experience in understanding the valuable information provided by financial statements. There are just some things that cannot be understood about the business except through the numbers. Our textbook gives the reader a more thorough, but intuitive, presentation on financial statements than do most other textbooks focused on small business management.
- Readers have described how the chapters on managing the business have kept them from making the kinds of mistakes that Andrew Mason and others have made.

We could continue discussing the textbook’s primary features, but hopefully the list above is sufficient to gain a sense of the book. But while *Small Business Management* offers a great foundation for an entrepreneurial career, we also encourage you to continue learning every day, building on the foundation provided by this text. This advice is supported by the words of Richard Branson, founder and chairman of the Virgin Group, which comprises more than 400 companies: “My biggest motivation? Just to keep challenging myself. Everyday I’m learning something new.”

Follow Your Dreams

As you will see, *Small Business Management* focuses on essential concepts and building skills that you will need to grow and manage a business successfully. But at the core, we also consider a much broader concern—the pursuit of entrepreneurial dreams.

Entrepreneurs should be about fulfilling dreams—for themselves, their families, their employees, and their communities. The journey should always be about more than just the money. As a small business owner, what you do matters, not just to yourself, but to others as well.

As you look to your future career path, there are definite advantages to initially working for someone else. It can allow you to learn an industry, build relationships, and develop important skills for the future. But many individuals choose to start their own company early in life:

- Michael Dell started assembling computer parts and selling personal computers in 1984 when he was a premed student at the University of Texas. From this humble start, Dell's company has gone on to become one of the largest technology companies in the world.
- Debbi Fields launched her business in 1977 when she was 21 years old, but it didn't take long for cookie fans everywhere to associate the Mrs. Fields name with the freshly baked specialty goods that they soon came to love. Though her venture was eventually acquired by an investment group, Fields has continued her involvement with the company and still serves as its spokesperson.
- Cecilia Ochoa Levine got her start in business sewing items for sale in local shops, but of course this limited her production. So, she moved to El Paso, Texas, and launched a company to make goods in Mexico for export to the U.S. That humble start, with only four seamstresses, led to a growing venture that now employs more than 400 people—but she still knows them all by name and even keeps up with news about their families. There is no question that Levine's impressive success as an entrepreneur has been built on a foundation of integrity and sincere generosity to others, a point that is explained further in Chapter 2.

This list could go on for pages. We all know entrepreneurs and small business owners who will not go on to become the next Elon Musk, but who will build or already own small businesses that create value and make a difference in the community. These small companies are the heart and soul of our economy.

So, we challenge you to give serious thought to joining them—and if you do, you may need to begin small, but *dream big if you want*. Follow a dream that you really care about and enjoy a life that you truly want to live! *Our best wishes to you for a challenging and successful learning experience!*

Change the Learning Model

When it comes to how we learn, the author team have become increasingly convinced over the years that what worked in the past no longer does for many individuals. More than ever, a learner's cooperation is required. That is, a student must take part in the process.

Learning can at times be hard work and requires a willingness to be engaged. However, it can be fun both for the teacher and student alike when the student is actively participating. Simply put, we believe that without engagement, there can be little meaningful learning. The intentionally crafted activities in MindTap simultaneously support learners in meaningful learning and aid busy instructors in teaching. Specific examples of this include scaffolded multiple-choice quizzes with robust feedback available to support student understanding, case activities that assess learner knowledge through cases that feature real small businesses and the challenges they experience, and study tools to help learners measurably succeed in the course.

Access Everything You Need in One Place

Cut down on prep with preloaded, organized course materials in MindTap. Teach more efficiently with interactive multimedia, assignments, quizzes, and more. Give your students the power to read, listen, and study on their smartphone or tablet so they can learn on their terms.

Empower Your Students to Reach Their Potential

Distinct metrics give you actionable insights into student engagement. Identify topics troubling your entire class and instantly communicate with struggling students. Students can track their scores to stay motivated toward their goals.

Personalize Your Course to Your Objectives

Only MindTap gives you complete control of your course. You have the flexibility to reorder textbook chapters, add your own notes, and embed a variety of content, including Open Education Resources (OER) and third-party content. Personalize course content to your students' needs—they can even read your notes, add their own, and highlight key text to aid progress.

Count on Our Dedicated Team, Whenever You Need Them

MindTap isn't simply an online learning tool—it's a network of support from a personalized team eager to further your success. We're ready to help, from setting up your course to tailoring MindTap resources to meet your specific objectives. You'll be ready to make an impact from day one. And we'll be right here to help you and your students throughout the semester—and beyond.

New Updates in Content

A primary purpose of *Small Business Management* is to present current, relevant content in unique and interesting ways, drawing on an abundance of real-world examples to keep the reader more interested. Thus, the 20th edition of *Small Business Management* offers plenty of updates, including the following:

- A host of misconceptions about becoming a small business owner can cause you to give up your entrepreneurial dream. We have revised Chapter 1, “The Entrepreneurial Life,” to help you better understand your motivations for starting a business and to avoid distorted concepts about what is required for you to be an effective business owner. Getting off on the right foot is critical to your success.
- Social entrepreneurship continues to be a major topic of conversation, both in small business practice and on college campuses. Recognizing this enduring trend, Chapter 2 introduces some of the important concepts and principles involved in the launch of a socially oriented enterprise. We have also included examples of socially minded entrepreneurs, such as Craig Gonsenhauser and Stacey Gorlick and their eco-friendly sunglasses start-up called Just Human, the community supporting work of Father Greg Boyle at Homeboy Industries, and Bart Weejuns and his venture that uses rats to sniff out unexploded landmines in war-torn nations around the world.

- Prioritizing a small business owner’s responsibility to major stakeholders can be difficult. With that in mind, Chapter 2, “Integrity, Ethics, and Social Entrepreneurship,” presents several new case examples of small business owners who have determined how best to balance stakeholder interests. These efforts provide a model for others who wish to improve their venture results.
- Chapter 3 introduces a new concept called the Opportunity Kaleidoscope, which provides a new way to organize innovative ideas that can help to identify potential new business possibilities. The related section of the chapter has been significantly reorganized to lead readers through a range of different perspectives on opportunity recognition.
- In the 19th edition, Chapter 4 was titled “Franchises and Buyouts.” In this edition, it is “Franchises and Independent Contracting in the Gig and Sharing Economies.” This chapter addresses start-up ventures that partner with other companies in contractual relationships. Franchisees and franchisors enter into agreements that often last 10 years or more, but both remain independent businesses. Similarly, independent contractors perform specified tasks for other, usually larger, companies. The terms of their agreements are more likely to be determined by the work to be performed, rather than a specified time period. Many students have discovered that the gig and sharing economies are providing opportunities to become independent contractors, particularly with driving and delivery services. For some, this opens doors to new entrepreneurial endeavors. There was an increase in new venture creation during the COVID-19 pandemic, with independent contracting being a path chosen by many.
- The section on Buyouts that had been in Chapter 4 has been updated and moved into Chapter 5, now titled “The Family Business and Buyouts.” We see that as a better fit because the transfer of ownership of a family firm is highly likely to be through a buyout. We replaced a subsection on the process of leadership succession with “Management and Ownership Succession” to highlight that two types of succession need to occur.
- The title of Chapter 6 has been changed from “The Business Plan: Visualizing the Future” to “The Business Model and the Business Plan” to place a greater emphasis on the importance of the business model than was reflected in earlier editions.
- We are delighted to continue offering *LivePlan* from Business Plan Pro, the unquestioned leader in business planning software. *LivePlan* has interactive features that guide you through the writing process in ways not previously available.
- The Formal Marketing Plan in Chapter 7 has been restructured to place more emphasis on taking action as opposed to conducting research. This reflects the behavior of entrepreneurial investors, including angels and venture capitalists, who have been calling for a shift away from the traditional planning process and toward business model development. A critical addition to the plan is a subsection on metrics, encouraging students to measure their progress toward marketing objectives. The marketing research section has been removed to prevent students from believing that they can become competent researchers based on the limited amount of information that the chapter could contain. We have added a new section on finding customers, a topic that is frequently expected to be integral to a business model. The chapter now introduces students to the Build-Measure-Learn Feedback Loop as a planning tool.

- Chapter 8 covers the organizational plan for a start-up or small business, and it has been further developed to provide direction for alternative paths that small business owners may choose to take. The statistics in the chapter have been updated to provide an accurate picture of current trends. We have also provided a more complete description of legal forms of organization that can be adopted, including the B Corporation, so that the reader will be able to pick the organizational form most suitable for his or her needs and interests.
- The number of small businesses being launched online continues to grow. Chapter 9, “The Location Plan,” includes an expanded section on effective models of e-commerce and emerging options that can lead to new business opportunities for entrepreneurs. This reflects the constantly changing landscape of online options available to small business owners who move to take advantage of these conditions.
- In a previous edition, we improved the presentation of financial statements (Chapter 10, “Understanding a Firm’s Financial Statements”) and the preparation of financial forecasts for small businesses (Chapter 11, “Forecasting Financial Requirements”). Our goal was to make the material more logical for the reader to follow. We have continued to build on this approach in the 20th edition to make the material even easier to grasp.
- Updated information on raising capital to grow a business, including best practices for raising money on the Internet (crowdfunding), is provided in Chapter 12, “A Firm’s Sources of Financing.” But stay tuned: Regulations concerning such topics are constantly evolving, and entrepreneurs must be aware of the fast-changing landscape of publicly raised capital.
- Because of the importance of establishing and improving relationships with customers, and the development of new and more sophisticated tools to make this more manageable, we continue to expand and update the sections on creating and using customer data in Chapter 14, “Building Customer Relationships.” These sections now offer more practical instruction on CRM methods that make sense for small businesses, regardless of the level of sophistication, and provide insights on the most recently available software packages that may be most suitable for a small business. The chapter also introduces three popular assessment tools that can help evaluate the experience customers have when working with a small business and presents a new model to untangle the factors that determine customers’ post-purchase satisfaction.
- Challenges related to product development continue to be among the most difficult that confront small firms, and Chapter 15 has been revised to reflect this. For this reason, the 20th edition includes, for example, more cutting-edge approaches in a significantly reworked section on the development of the physical product.
- Small business owners are discovering that social media can offer cost-effective ways of getting their message out. They are also learning that more and more customers rely on social media to make buying decisions. With this in mind, Chapter 17, “Promotional Planning,” has been rewritten to place greater emphasis on social media marketing strategies.
- An increasing number of small business owners are considering options to grow their ventures via international expansion. However, many are realizing that overseas locations differ across many relevant variables. Chapter 18 provides more information about contextual conditions in specific country markets to guide entrepreneurs in their planning for global growth.

- Because legal regulations related to human resource management practices continue to become more complicated and change constantly, Chapter 20, “Managing Human Resources,” has been updated to be sure the information provided about the law and best practices in HR is accurate. Of course, it is important for small business owners to continue to seek further updates as laws and regulations in this area of practice are dynamic and always subject to revision.
- The world of health care and insurance provided by small businesses is undergoing major changes. Chapter 23, “Managing Risk in the Small Business,” has been revised to help entrepreneurs adjust to recent changes.
- Updated Living the Dream features in each chapter capture entrepreneurs in action as they face small business and entrepreneurship challenges. The authors’ personal conversations and correspondence with many of the entrepreneurs profiled add depth to these features and ensure accuracy.

“Spotlight on Small Business” features at the start of each chapter profile an amazing collection of entrepreneurs whose unique insights into how to start, run, and grow a business will help readers identify and explore the full range of issues facing today’s business owners.
- We have focused on providing new cases for most of the chapters of the book, with 15 of the 23 cases being new with this edition. Cases retained from the 19th edition have all been updated.

Updated and Enhanced Supplements

All resources and ancillaries that accompany *Small Business Management*, 20th edition, have been created to support a variety of teaching methods, learning styles, and classroom situations.

- **Instructor’s Manual.** Lecture notes in the *Instructor’s Manual* are grouped by learning objective and contain sources of other instructional materials, answers to the “Discussion Questions,” comments on “You Make the Call” situations, and additional teaching notes.
- **Test Bank.** Questions in the *Test Bank* are grouped by learning objectives and include true/false, multiple-choice, and discussion questions. Metadata tags are attached to each question.
- **Cognero® Testing Software.** Cengage Learning Testing Powered by Cognero® is a flexible, online system that allows you to import, edit, and manipulate content from the text’s *Test Bank* or elsewhere, including your own favorite test questions; create multiple test versions in an instant; and deliver tests from your LMS, your classroom, or wherever you want.
- **PowerPoint® for Instructors.** A complete PowerPoint® package is available to aid in lecture presentation. The PowerPoint® slides are available on the password-protected instructor resource website.
- **LivePlan®.** Students learn how to use the award-winning, best-selling professional software *LivePlan* to create a business plan. This online resource provides all the essentials to create winning business plans, including step-by-step instructions for preparing each section of a plan. Ready-to-customize samples, advice, a detailed marketing analysis with links to demographic and marketing tools, and helpful financial tools make it easy to create a solid plan. Video and written tutorials from Palo Alto Software founder Tim Berry ensure that students fully understand how to maximize *LivePlan’s* dynamic tools.

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Assumption College
James R. Hindman
Northeastern University
Betty Hoge
Limestone College
Eddie Hufft
Alcorn State University
Sherrie Human
Xavier University
Ralph Jagodka
Mt. San Antonio College
Larry K. Johansen
Park University
Michael Judge
Hudson Valley Community College
Mary Beth Klinger
College of Southern Maryland
Charles W. Kulmann
Columbia College of Missouri
Rosemary Lafragola
University of Texas at El Paso
William Laing
Anderson College
Ann Langlois
Palm Beach Atlantic University
Rob K. Larson
Mayville State University
David E. Laurel
South Texas Community College
Alecia N. Lawrence
Williamsburg Technical College
Les Ledger
Central Texas College

Michael G. Levas
Carroll University
Richard M. Lewis
Lansing Community College
Thomas W. Lloyd
Westmoreland County Community College
Elaine Madden
Anne Arundel Community College
Kristina Mazurak
Albertson College
James J. Mazza
Middlesex Community College
Lisa McConnell
Oklahoma State University
Richard McEuen
Crowley's Ridge College
Angela Mitchell
Wilmington College
Frank Mitchell
Limestone College
Douglas Moesel
University of Missouri–Columbia
Michael K. Mulford
Des Moines Area Community College
Bernice M. Murphy
University of Maine at Machias
Eugene Muscat
University of San Francisco
John J. Nader
Grand Valley State University
Marc Newman
Hocking College
Charles “Randy” Nichols
Sullivan University
Robert D. Nixon
University of Louisville
Marcella M. Norwood
University of Houston
Mark Nygren
Brigham Young University–Idaho
Donalus A. Okhomina Sr.
Jackson State University
Rosa L. Okpara
Albany State University
Timothy O’Leary
Mount Wachusett Community College
Pamela Onedeck
University of Pittsburgh at Greensburg

Dick Petite <i>SUNY Brockport & Monroe Community College</i>	Sherry L. Shuler <i>American River College</i>	<i>Macomb Community College</i>
Claire Phillips <i>North Harris College</i>	Cindy Simerly <i>Lakeland Community College</i>	Darrell Thompson <i>Mountain View College</i>
Dean Pielstick <i>Northern Arizona University</i>	James Sisk <i>Gaston College</i>	Melodie M. Toby <i>Kean University</i>
Mark S. Poulos <i>St. Edward's University</i>	Victoria L. Sitter <i>Milligan College</i>	Charles N. Toftoy <i>George Washington University</i>
Julia Truitt Poynter <i>Transylvania University</i>	Bernard Skown <i>Stevens Institute of Technology</i>	Charles Torti <i>Schreiner University</i>
Fred Pragasam <i>University of North Florida</i>	Kristin L. H. Slyter <i>Valley City State University</i>	Gerald R. Turner <i>Limestone College</i>
Thomas Pressly <i>Penn State–Shenango</i>	William E. Smith <i>Ferris State University</i>	Barry L. Van Hook <i>Arizona State University</i>
Mary Ellen Rosetti <i>Hudson Valley Community College</i>	Bill Snider <i>Cuesta College</i>	Brian Wahl <i>North Shore Community College</i>
June N. Roux <i>Delaware Technical and Community College</i>	Roger Stanford <i>Chippewa Valley Technical College</i>	Mike Wakefield <i>University of Southern California</i>
Jaclyn Rundle <i>Central College</i>	George Starbuck <i>McMurry University</i>	Charles F. Warren <i>Salem State College</i>
John K. Sands <i>Western Washington University</i>	Phil Stetz <i>Stephen F. Austin State University</i>	Bill Waxman <i>Edison Community College</i>
Craig Sarine <i>Lee University</i>	Johnny Stites <i>J&S Construction</i>	Janet Wayne <i>Baker College</i>
Duane Schecter <i>Muskegon Community College</i>	Peter L. Stone <i>Spartanburg Technical College</i>	Charles Wellen <i>Fitchburg State College</i>
Joseph A. Schubert <i>Delaware Technical and Community College</i>	John Streibich <i>Monroe Community College</i>	Nat B. White Jr. <i>South Piedmont Community College</i>
Matthew Semadeni <i>Texas A&M University</i>	Ram Subramanian <i>Montclair State University</i>	Jim Whitlock <i>Brenau University</i>
Marjorie Shapiro <i>Myers University</i>	James Swenson <i>Minnesota State University Moorhead</i>	Ira Wilsker <i>Lamar Institute of Technology</i>
	Ruth Tarver <i>West Hills Community College</i>	Patricia A. Worsham <i>Cal Poly Pomona</i>
	Paul B. Thacker	

To the Instructor

As a final word of appreciation, we express our sincere thanks to the many instructors who use our text in both academic and professional settings. Based on years of teaching and listening to other teachers and students, *Small Business Management* has been designed to meet the needs of its readers. And we continue to listen and make changes in the text. Please write or call us to offer suggestions to help us make the book even better for future readers. Our contact information is Bill Petty (254-710-2260, bill_petty@baylor.edu), Les Palich (254-710-6194, les_palich@baylor.edu), and Frank Hoy (508-831-4998, fhoy@wpi.edu). We would love to hear from you, we seriously would!

About the Authors



Justin G. Longenecker

Justin G. Longenecker's authorship of *Small Business Management* began with the first edition of this book. He authored a number of books and numerous articles in such journals as *Journal of Small Business Management*, *Academy of Management Review*, *Business Horizons*, and *Journal of Business Ethics*. He was active in several professional organizations and served as president of the International Council for Small Business. Dr. Longenecker grew up in a family business. After attending Central Christian College of Kansas for two years, he went on to earn his BA in political science from Seattle Pacific University, his MBA from The Ohio State University, and his PhD from the University of Washington. He taught at Baylor University, where he was Emeritus Chavanne Professor of Christian Ethics in Business until his death in 2005.

J. William Petty

J. William "Bill" Petty was Professor of Finance and served as the W. W. Caruth Chairholder in Entrepreneurship at Baylor University from 1990 through 2018. He was the founding executive director of the Baylor Angel Network, eventually consisting of over 100 angel investors. He holds a PhD and an MBA from the University of Texas at Austin and a BS from Abilene Christian University. He has taught at Virginia Tech University and Texas Tech University and served as dean of the college of business at Abilene Christian University. He has taught entrepreneurship and small business courses in China, Ukraine, Kazakhstan, Indonesia, Thailand, and Russia. Dr. Petty was designated a Master Teacher at Baylor and was named the National Entrepreneurship Teacher of the Year in 2008 by the Acton Foundation for Excellence in Entrepreneurship. His research interests included acquisitions of privately held companies, shareholder value-based management, the financing of small and entrepreneurial firms, angel financing, and exit strategies for privately held firms. He has served as co-editor for the *Journal of Financial Research* and as editor of the *Journal of Entrepreneurial Finance*. He has published articles in a number of finance journals and is the co-author of a leading corporate finance textbook, *Foundations of Finance*. He is a co-author of *Value-Based Management in an Era of Corporate Social Responsibility* (Oxford University Press, 2010). Dr. Petty has worked as a consultant for oil and gas firms and consumer product companies. He also served as a subject-matter expert on a best-practices study by the American Productivity and Quality Center on the topic of shareholder value-based management. He was a member of a research team sponsored by the Australian Department of Industry to study the feasibility of establishing a public equity market for small and medium-size enterprises in Australia. Finally, he serves as the audit chair for a publicly traded energy firm.

Leslie E. Palich

Leslie E. "Les" Palich is Professor of Entrepreneurship and the W. A. Mays Professor of Entrepreneurship and Strategic Management at Baylor University, where he teaches

small business management, international entrepreneurship, strategic management, and international management to graduate and undergraduate students. He was also named a Fulbright Scholar to Ireland in 2022, where he conducted research on the ethical attitudes of small business owners and entrepreneurs and the impact these perspectives have on venture performance. Dr. Palich holds a PhD and an MBA from Arizona State University and a BA from Manhattan Christian College. His research has been published in the *Academy of Management Review*, *Strategic Management Journal*, *Entrepreneurship Theory & Practice*, *Journal of Business Venturing*, *Journal of International Business Studies*, *Journal of Management*, *Journal of Organizational Behavior*, *Journal of Small Business Management*, and several other periodicals.

He has taught entrepreneurship and strategic management in a host of overseas settings in Europe and Latin America and often serves as a visiting professor at the Centre Franco-Americain de Management International, Institute d'Administration des Entreprises de Caen at the University of Caen in France. His interest in entrepreneurial opportunity and new venture creation dates back to his grade school years, when he first started to experiment with small business ownership. That early experience became a springboard for a number of other enterprises. Since that time, he has owned and operated domestic ventures in agribusiness, automobile sales, real estate development, and educational services, as well as an international import business. Dr. Palich also owned and operated Lead Generation X, an Internet marketing firm that employs cutting-edge promotional methods to serve its clients and their customers.

Frank Hoy

Frank Hoy is Professor of Innovation & Entrepreneurship Emeritus and was director of the Collaborative for Entrepreneurship and Innovation at Worcester Polytechnic Institute. Dr. Hoy earned his PhD at Texas A&M University where he developed a small business outreach program for the Texas Agricultural Extension Service. Subsequently, he served on the faculty in the Department of Management at the University of Georgia, where he became director of the Small Business Development Center for the State of Georgia. He moved to Georgia State University in 1988 as the Carl R. Zwerner Professor of Family-Owned Businesses, the first endowed faculty position in the United States devoted to family business education and research. From 1991 to 2001, Dr. Hoy was dean of the College of Business Administration, and from 2001 to 2009, director of the Entrepreneurship Centers at the University of Texas at El Paso.

Dr. Hoy has been the recipient of numerous academic and professional recognitions for his contributions to small business and entrepreneurship education and research, including the Max S. Wortman/USASBE Lifetime Achievement Award from the United States Association for Small Business and Entrepreneurship, the first Mentorship Award given by the Entrepreneurship Division of the Academy of Management, the Freedoms Foundation Leavey Award for Excellence in Private Enterprise Education, the Regional Research Advocate of the Year from the United States Small Business Administration, selection to the El Paso, TX, Business Hall of Fame, and others.



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Chapter

1

The Entrepreneurial Life

Learning Objectives

The primary purpose of The Entrepreneurial Life chapter is to provide you an overall view of owning a small business and thinking like an entrepreneur. By studying this chapter, you should be able to . . .

- 1-1** Explain the importance of small businesses and entrepreneurship in our society.
- 1-2** Describe what it means to be a small entrepreneurial firm.
- 1-3** Identify how small businesses can compete against the giants.
- 1-4** Outline what might motivate you to be a small business owner with all its risks and uncertainties.
- 1-5** Describe ways to build a successful business as a part of your life legacy.



▶ Spotlight on Small Business

Energy Solutions of Texas

www.energysolutionstx.com



DARRELL AND RAY CLOUDT

Energy Solutions of Texas (ESOT) was founded in 2005 by Darrell and Ray Cloudt, a father and son team. Both men had previously worked for a well-known franchise company—the son in sales and the father in franchisee support. It was during that experience that the Cloudts began dreaming about starting their own business.

They had their eye on starting a solar energy business but then decided to pivot away from an industry that was still developing and was dependent on government incentives. Instead, they determined that there was a greater opportunity in commercial lighting retrofits, where profits would be more stable, in part due to the electrical power distribution companies incentivizing lighting projects as a way to reduce peak demand.

To gain a competitive edge over larger and more established competitors, including lighting equipment manufacturers, they planned to (1) offer a turn-key price (a set price from beginning to end), (2) provide assistance with incentive procurements from power companies, and (3) be present for installation and on-site start-up of the system.

They also recognized that they would face some daunting challenges:

1. Reliable equipment suppliers had to be identified.
2. Installation subcontractors and their crews needed to be vetted quickly.
3. An effective marketing strategy had to be developed.
4. Everything had to be done on a really tight budget.

To offset some of these challenges, they were able to get a foothold by purchasing an existing lighting retrofit business and hiring the founder as a project manager. Also, to control costs, the business was operated out of a home

office and rented space for the first four years. Start-up funding came from personal savings and a line of credit underwritten by a family friend and successful businessman, who also became a trusted adviser and mentor.

The company's basic growth strategy was to go after the low-hanging fruit by identifying projects that (1) did not require a large capital expenditure by the customer, (2) allowed the customer to recoup the capital outlay in less than two years, and (3) would qualify for substantial incentives.

Initially, the market area was central Texas, targeting churches, schools, and smaller commercial facilities. Because the new technology was far superior to that used in the old lighting equipment, ESOT was profitable in the second year of operations and ready to expand sales to larger manufacturing facilities.

Fast forward to 2021, and the market area focus has widened to five south central U.S. states. Every lighting project now has LED technology that outperforms the equipment that ESOT was installing from 2005 to 2014. Also, ESOT has diversified with specialized fans to control the accumulation of combustible dust, commercial vacuum equipment, and thermal imaging cameras.

The diversification was a result of recognizing an opportunity while doing a lighting project in a diaper factory where airborne lint created fuel for fires and potential explosions. The electrical and mechanical skills of ESOT's subcontractors easily handled these additional projects and created a synergy of solutions to offer customers.

The Cloudts attribute their success to being able to inspire confidence in ESOT's capabilities by doing the following:

1. Having sound knowledge of what the equipment can do and how ESOT can offer a solution to a problem.
2. Being skilled at asking questions of the customer and listening with the intent of coming to a satisfactory solution.
3. Being on-site and communicating with the project manager at critical times during the project.
4. Following up with the customer by asking "Is there anything that we could have done better?" and "Is the equipment performing as expected?"

Both Darrell and Ray strongly believe that by using this relationship-building philosophy, ESOT will likely be invited to do projects in other customer-owned locations. They see a bright future as small business owners—and they love it.

Source: Adapted from personal communication with Ray Cloudt, March 12, 2021.

As the co-authors of *Small Business Management: Launching and Growing Entrepreneurial Ventures*, we have spent decades interacting with entrepreneurs—as friends, as consultants, and even as investors. It has been a blast! These experiences have largely framed what we teach in class, our areas of research, and ultimately what we present in this book.

And now we want you to know what we have learned over the years, so that you will be prepared to own a small business—one that hopefully will make a difference in your life, as well in the lives of many others. We want your study of entrepreneurship and small business management to be more than just learning facts for an exam. *More importantly, we want to equip you with the necessary tools for a journey that could be life changing.*

To begin, we want you to understand the following:

- Owning a business is a noble profession—*especially if it's done well*. No other life's work does more to further your personal development and allows you to make significant contributions to society.
- The richest rewards of owning a small business come from (1) offering goods or services that improve the lives of your customers and make a difference in the community, and (2) developing an organizational culture that allows your employees to grow professionally and personally.

So, let's get started by looking at some big-picture issues for anyone wanting to think like an entrepreneur and be a small business owner.

1-1 Small Size, Big Significance

Without question, entrepreneurship is a major social phenomenon in the United States and in many other countries around the globe. In fact, the average level of entrepreneurial activity has increased over the past 19 years, with approximately 500,000 new businesses started each month.¹ Most importantly, owning a small business changes lives, both that of the entrepreneur and those of employees and customers. Much of this chapter will explain how owning your own business is closely connected to your life.

Small businesses also make significant contributions to the economy. Here are just a few more statistics, some good news and some bad, that you might find of interest:²

- There are 30.2 million small businesses in the United States with fewer than 500 employees, accounting for 99.7 percent of all businesses—and 89 percent have fewer than 20 employees!
- There are 11.7 million women-owned businesses, representing 36 percent of all small businesses.
- There are 9.2 million minority-owned small businesses in the United States, accounting for 29 percent of all small businesses.
- Fifty-nine million people work in small businesses, representing 47 percent of all employees and 42 percent of all salaries paid to employees.
- Many small companies have gone global, representing 97 percent of all exporters.³
- Two-thirds of all small businesses survive for at least two years, while around 33 percent survive over ten years. Fifty percent of the failures are due to cash flow problems, with 14 percent being the result of poor marketing strategies.
- Finally, 64 percent of small businesses begin with only \$10,000 in capital. However, 27 percent of small businesses are not able to get the financing they need.

1-1 Explain the importance of small businesses and entrepreneurship in our society.

Devra Gartenstein expresses it well:⁴

Small businesses are important because they provide opportunities for entrepreneurs and create meaningful jobs with greater job satisfaction than positions with larger, traditional companies. They foster local economies, keeping money close to home and supporting neighborhoods and communities.

The importance of small businesses and entrepreneurship is also reflected in the interest that young people have in eventually owning their own business, as indicated by the number of college students enrolling in small business management and entrepreneurship classes.

So, small businesses are important contributors to our economy and deserve careful study by anyone contemplating becoming a business owner, especially the owner of a small firm that could become a medium or large business over time.

1-2 Describe what it means to be a small entrepreneurial firm.

1-2 Small Business and Entrepreneurship

Let's now look at the terms *small business* and *entrepreneurship*, and consider how small firms and entrepreneurs often go together.

1-2a What Is a Small Business?

What does it mean to be a small business? A neighborhood restaurant or bakery is clearly a small business, and Toyota is obviously not. To distinguish between small and large businesses, we naturally consider their relative sizes, but it is also helpful to think about a small firm's potential to grow. Consider, too, that small firms with different growth potential require different management.

Size

In this case, size is in the eye of the beholder. When we think about a firm's size, we typically use such criteria as the number of employees, its sales volume, its amount of profit, and the size of the company's assets. However, size standards are arbitrary and frequently adopted to serve a purpose. For example, the U.S. Small Business Administration generally defines a small business as having fewer than 500 employees. However, in specific cases, the government may define a small business differently—such as one with fewer than 10 employees—to exempt it from certain regulations if compliance would be too costly, given its small size. Therefore, using numerical criteria can be subjective at best.

Growth Potential

Small businesses also differ dramatically when it comes to their potential to grow and how they must be managed. They have commonly been differentiated as follows:

1. **Microbusinesses** make up the largest sector of the U.S. economy in terms of the number of businesses. This sector includes many small service companies, such as pool-cleaning businesses, dry cleaners, and appliance repair shops. These companies are also called **lifestyle businesses** because they mostly support an owner's desired lifestyle, not only by providing needed income, but also in allowing greater flexibility in their daily life. And that's not all bad.

microbusiness

A small firm that provides minimal profits to its owner.

lifestyle business

A microbusiness that permits the owner to follow a desired pattern of living.



Living the Dream

Always Go the Extra Mile



When Johnny Stites, the former CEO of J&S Construction Company, talks to aspiring entrepreneurs, he often tells them that he learned an important lesson while still in college, which he carried into his 43 years in business.

I sold books for Southwestern Publishing Company, door to door, in the summers between my college semesters. I learned that when I focused on making money or how many sales I had made, I did not enjoy my job nearly as much as when I focused on helping people. I also did not make as much money.

I carried that into my construction career of 43 years. During that time, I realized again my time was much more enjoyable when I focused first on those I sought to help. I observed that my construction crews were far more fulfilled in their jobs when I started emphasizing and measuring the clients' reaction to our construction teams. It magnified the "self-worth" of construction workers, an industry with one of the lowest self-esteem on earth. When they began to

focus on the needs of our clients, instead of their own issues at work, they enjoyed their day better and did a more professional job.

J&S Construction Company was founded in 1957 by Johnny's father, John D. Stites. He created the business's name for his vision of a J[ohn] & S[ons] Construction Company. At the time, Johnny was only 11 years old and his younger brother, Jack, was 9 years old. Johnny says, "Our dad was a great visionary, as evidenced by the planning in the name."

The company remained a small residential construction company operating in Cookeville, Tennessee, until the late 1960s when John D. Stites began to perform smaller commercial projects. In 1971, Johnny joined the company after graduation from college and a three-year tour in the U.S. Navy during the Vietnam conflict. Jack joined the business shortly afterwards.

Over the 43 years of their family leadership in the company, J&S Construction Company grew from five employees with annual sales of \$250,000 in one small Tennessee community to a company of 125 employees with annual revenues of \$46 million, performing work in six states.

Johnny maintains that their successful run would not have happened if not for the wisdom they gained from their faith.

Even when we fulfilled our contracts completely, we did not develop deeply committed customers because they only got what they paid for. Ultimately, our company lost a very valued client because we only gave what was in the contract, and not a penny more. Over a few hundred dollars, the company lost \$20 million of future construction revenue. From that experience, we decided to follow the faith-based principle of "going the extra mile" for others. We focused on treating others how we would like to be treated. We revised every aspect of our business to ensure every person was incentivized to go the extra mile and take care of our clients. We wanted every client to tell us that they were "delighted" at the end of their project; not "pleased," not "satisfied," and

certainly not “disappointed.” We made our best profits when everyone on every project was delighted. When customers would question me why laborers on their jobs were asking them if they were delighted, I knew we were getting close to true success.

Johnny Stites has since retired. But he has continued to make a difference. His first two years after retirement were spent advising the state of Tennessee on how to improve government contracting operations.

His report provided a pathway for Tennessee to save \$100 million annually in construction expenses through process improvement. The next two years were spent consulting with small businesses, showing them how to gain traction in order to achieve their visions.

Today, Johnny is managing his real estate holdings, traveling, and spending time with his four children and his 14 grandchildren—still making a difference!

Source: Personal conversation with Johnny Stites, March 15, 2021.

attractive small firm

A small firm that provides substantial profits to its owner.

high-potential venture (gazelle)

A small firm that has great prospects for growth.

small business

A business with growth potential that is small compared to large companies in an industry, has geographically localized operations, is financed by only a few individuals, and has a small management team.

entrepreneur

A person who relentlessly pursues an opportunity, in either a new or an existing business, to create value while assuming both the risk and the reward for their efforts.

entrepreneurship

The relentless pursuit of an opportunity without regard to owning all the resources needed to capture the opportunity.

2. **Attractive small firms** offer substantial financial rewards for their owners, where profits may grow into the millions or even tens of millions of dollars. They can also provide rewarding careers for employees.
3. **High-potential ventures** (also called **gazelles**) are businesses with phenomenal prospects for growth. These firms usually deal with cutting-edge technology and have the potential to change how people live.

So, how we think of a **small business** depends on how we define *small* and on the nature of the business in terms of its growth potential. For our purposes, we will primarily be interested in businesses with the following characteristics:

1. Compared to the largest firms in the industry, the business is small; in most instances, it has fewer than 100 employees.
2. Except for its marketing function, the business’s operations are geographically localized.
3. No more than a few individuals provide equity financing for the business. Equity financing (discussed in Chapter 12) is money invested in the business by the owners and, possibly, by a few other individuals.
4. The business may begin with a single individual, but it must have the potential to become at least a mid-sized company, whether or not the owner chooses to capture that growth.

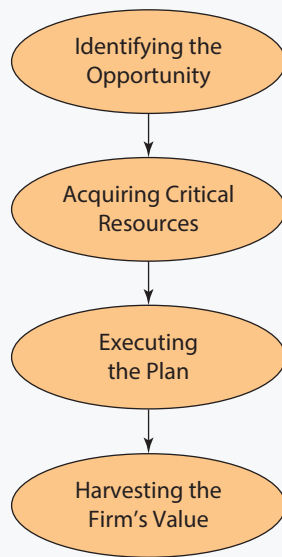
Obviously, some small businesses will fail to have these characteristics, but they may still be of interest to us.

1-2b What Is Entrepreneurship?

There is no single definition of *entrepreneurship*. Some focus on the willingness of a person (the **entrepreneur**) to create value while assuming both significant risks and rewards for their efforts in a new or existing business venture. Others target innovations created by entrepreneurs, while still others focus on the personality traits of entrepreneurs.

We prefer a working definition of *entrepreneurship* that focuses on the process: **Entrepreneurship** is the relentless pursuit of an opportunity without regard to owning all the resources needed to capture the opportunity. It involves a process that begins with identifying an opportunity and ends with exiting the business, or what is often called “harvesting the value of the company.”

Exhibit 1.1 The Entrepreneurial Process



From beginning to end, entrepreneurship involves four stages, which are reflected in Exhibit 1.1:

1. *Identifying an attractive opportunity.* Understand that an opportunity is more than merely having a good idea. Real opportunities should be market driven, offering customers a product or service that is so appealing that they are willing to let go of their hard-earned money to buy it. (In Chapter 3, you'll learn how to identify good opportunities.)
2. *Acquiring the critical resources needed for growing the business.* In a small business, there is no issue more important than efficiently managing resources. Entrepreneurs need to find ways to do more with less. Thus, learning how to think about critical resources may mean the difference between success and failure.

When entrepreneurs think about resources, they should not just think about money. Critical resources also include the right management team, the right partners, and access to the right assets, such as inventory and equipment. To gain the necessary resources, entrepreneurs sometimes must **bootstrap**, such as resorting to bartering, generating income from other sources, or using a personal credit card.

3. *Executing the plan.* The entrepreneur must now scale the business to make it economically attractive. Among other things, they need to know how the firm will make money, support growth, and create barriers to entry to keep the competition away.
4. *Harvesting the business.* At some point, an entrepreneur must think about exiting the business to capture the value that they have created over the years. This can happen by passing the business on to the next generation in the family, by selling the company to other investors, or in a few rare instances, by issuing the company's stock to the public. (These options will be explained in detail in Chapter 13.)

bootstrap

Doing more with less in terms of resources invested in a business, and, where possible, controlling the resources without owning them.

Entrepreneurial Attributes

“Are entrepreneurs born or made?” That question has long been debated with little agreement. However, instead of trying to resolve that issue, Stephen Spinelli and Robert Adams have summarized research on entrepreneurial characteristics, including “desirable and acquirable attitudes and behaviors”:⁵

1. *Leadership abilities*—The abilities to self-motivate and team-build, with a focus on honesty in business relationships.
2. *Opportunity obsession*—A keen awareness of the market and customer needs.
3. *Commitment and determination*—Tenacity, decisiveness, and persistence in problem solving.
4. *Motivation to excel*—Goal orientation and awareness of personal strengths and weaknesses.
5. *Courage*—Strong moral convictions and a willingness to experiment.
6. *Tolerance of risk, ambiguity, and uncertainty*—The ability to take risks and to minimize them, as well as to tolerate uncertainty.
7. *Creativity, self-reliance, and adaptability*—Open-mindedness, resilience, and a quickness to learn.

On the other hand, some personal characteristics are deadly for an entrepreneur. An almost certain way to fail as an entrepreneur, as many have learned by experience, is to do the following:

1. Overestimate what you can do.
2. Lack an understanding of the market.
3. Hire mediocre people.
4. Fail to be a team player (usually the result of taking oneself too seriously).
5. Be a domineering manager.
6. Fail to share ownership in the business in an equitable way.

Three Harvard Business School professors came to similar conclusions based on a survey that asked company founders what they got wrong when starting their companies.⁶ Overall, they acknowledged not being good listeners in two areas:

- They did not listen to prospective customers as they were designing their product or service. Instead, they “built” what they thought customers would want without ever asking.
- Their passion and egos caused them to react negatively to criticism and to discount ideas from others for improving their products or services. We frequently hear that an entrepreneur must have passion, which is true, but *unchecked passion can be destructive*.

To some extent, these traits describe a leader who lacks humility, a quality that we believe serves business leaders well.

Clearly, successful—and unsuccessful—entrepreneurs share certain characteristics. However, entrepreneurs are not cut from a single mold. You have only to listen to their stories to hear the apparent differences in their priorities, perceptions, personalities, and behavior. Their success generally arises from having a clear mission, a desire to lead, and the recognition that business success requires hard work and long hours.



Living the Dream

Pursuing Your Calling

There is no way around it, starting and building a successful business are hard. One excellent way to succeed is by pursuing a calling to make a difference in others' lives.

That's the path that April Anthony took. As the founder and CEO of Encompass Home Health & Hospice, she started and built her company during an industry recession, if not depression, that wiped out nearly a third of her competitors.

My entry into home health care came accidentally. I wasn't looking for a career, I was simply looking for a short-term job on my way to becoming a stay-at-home mom. However, much to my surprise, when I entered the home health care industry, I not only found a job, I found my life's calling and my passion. When you find your passion, everything changes.



JEFF WILSON/THE FORBES COLLECTION/GETTY IMAGES

I became so convinced about why we had to deliver exceptional care to our elderly patients that I was determined to figure out how to do it better than anyone else. When you find your calling, the hurdles that you face as an entrepreneur no longer seem so daunting. Instead, your commitment to overcome them becomes almost obsessive.

After 28 years, I can honestly say that I love my work today as much as I ever have because it isn't really work—it is my calling, my passion, and my inspiration.

In 2021, Encompass Health is publicly traded and the fourth-largest Medicare-approved provider of home health care in the United States. However, since coronavirus was declared a global pandemic in early March 2020, Anthony has had to work diligently to keep her 8,000-plus nurses and therapists, along with 40,000 high-risk patients, safe from COVID-19.

Anthony says that nothing prepared her for COVID-19, but her experience, determination, and faith helped her face the really tough days. And in early 2021, the company was not only surviving, but once again prospering.

Sources: Personal correspondence with April Anthony, March 2021; and "How April Anthony Made a \$700 Million Fortune in One of the Toughest Corners of U.S. Healthcare," June 22, 2020, <https://www.forbes.com/sites/hayleycuccinello/2020/06/22/april-anthony-healthcare-self-made-women/?sh=35b706551fdc>, accessed March 1, 2021.

Types of Entrepreneurs

Entrepreneurs are not only founders of new businesses. Many individuals approach entrepreneurship a bit differently—but are entrepreneurial just the same. Let's now consider several different types of entrepreneurs.

Second-Stage Entrepreneurs. At some point after a new firm is established, it may be purchased or taken over by a second-generation family member or another individual