

ENTREPRENEURSHIP

SIXTH EDITION

ROBERT D. HISRICH, PH.D.

*A. Malachi Mixon III Professor of Entrepreneurial Studies
Chair, Entrepreneurship and Policy Divisions
Weatherhead School of Management
Case Western Reserve University*

MICHAEL P. PETERS, PH.D

*Professor Emeritus
Carroll School of Management
Boston College*

DEAN A. SHEPHERD, PH.D

*Assistant Professor
Leeds School of Business
University of Colorado at Boulder*



**McGraw-Hill
Irwin**

Boston Burr Ridge, IL Dubuque, IA Madison, WI New York San Francisco St. Louis
Bangkok Bogota Caracas Kuala Lumpur Lisbon London Madrid Mexico City
Milan Montreal New Delhi Santiago Seoul Singapore Sydney Taipei Toronto

CONTENTS

PREFACE xix

| | | |
|---------------|--|-----------|
| PART 1 | THE ENTREPRENEURIAL PERSPECTIVE | 1 |
| 1 | THE NATURE AND IMPORTANCE OF ENTREPRENEURS | 2 |
| | Opening Profile: Oprah Winfrey 3 | |
| | Nature and Development of Entrepreneurship 6 | |
| | Earliest Period 6 | |
| | Middle Ages 6 | |
| | 17th Century 6 | |
| | 18th Century 7 | |
| | 19th and 20th Centuries 7 | |
| | Definition of Entrepreneur Today 8 | |
| | The Entrepreneurial Decision Process 9 | |
| | Change from Present Lifestyle 10 | |
| | Desirability of New Venture Formation 11 | |
| | Possibility of New Venture Formation 12 | |
| | Types of Start-Ups 14 | |
| | Role of Entrepreneurship in Economic Development 15 | |
| | Government as an Innovator 15 | |
| | Intrapreneurship 17 | |
| | Entrepreneurship 17 | |
| | Entrepreneurial Careers and Education 17 | |
| | Ethics and Social Responsibility of Entrepreneurs 22 | |
| | The Future of Entrepreneurship 23 | |
| 2 | THE ENTREPRENEURIAL AND INTRAPRENEURIAL MIND | 34 |
| | Opening Profile: Ewing Marion Kauffman 35 | |
| | The Entrepreneurial Process 38 | |
| | Identify and Evaluate the Opportunity 38 | |
| | Develop a Business Plan 40 | |
| | Determine the Resources Required 40 | |
| | Manage the Enterprise 40 | |
| | Managerial versus Entrepreneurial Decision Making 41 | |
| | Strategic Orientation 42 | |
| | Commitment to Opportunity 42 | |
| | Commitment of Resources 42 | |
| | Control of Resources 42 | |
| | Management Structure 42 | |

CONTENTS

| | |
|---|----|
| Causes for Interest in Intrapreneurship | 43 |
| Corporate versus Intrapreneurial Culture | 45 |
| Climate for Intrapreneurship | 48 |
| Intrapreneurial Leadership Characteristics | 49 |
| Establishing Intrapreneurship in the Organization | 51 |
| Problems and Successful Efforts | 52 |

THE INDIVIDUAL ENTREPRENEUR

58

Opening Profile: Robert Mondavi 59

| | |
|--|----|
| Entrepreneurial Feelings | 62 |
| Locus of Control | 62 |
| Feelings about Independence and Need for Achievement | 63 |
| Risk Taking | 64 |
| Entrepreneur Background and Characteristics | 64 |
| Childhood Family Environment | 64 |
| Education | 65 |
| Personal Values | 65 |
| Age | 66 |
| Work History | 67 |
| Motivation | 67 |
| Role Models and Support Systems | 68 |
| Moral-Support Network | 68 |
| Professional-Support Network | 68 |
| Male versus Female Entrepreneurs | 69 |
| Minority Entrepreneurship | 72 |
| Entrepreneurs versus Inventors | 73 |

INTERNATIONAL ENTREPRENEURSHIP OPPORTUNITIES

82

Opening Profile: A. Malachi Mixon, III 83

| | |
|--|----|
| The Nature of International Entrepreneurship | 86 |
| The Importance of International Business to the Firm | 86 |
| International versus Domestic Entrepreneurship | 87 |
| Economics | 87 |
| Stage of Economic Development | 87 |
| Balance of Payments | 87 |
| Type of System | 87 |
| Political-Legal Environment | 88 |
| Cultural Environment | 88 |
| Technological Environment | 90 |
| Strategic Issues | 90 |
| Entrepreneurial Entry into International Business | 92 |
| Exporting | 92 |
| Nonequity Arrangements | 93 |
| Direct Foreign Investment | 94 |
| Barriers to International Trade | 96 |
| General Agreement on Tariffs and Trade (GATT) | 96 |
| Increasing Protectionist Attitudes | 98 |

| | |
|--|----|
| Trade Blocs and Free Trade Areas | 98 |
| Entrepreneur's Strategy and Trade Barriers | |
| Entrepreneurial Partnering | 99 |

CASES FOR PART 1

| | | |
|----------------|---|------------|
| Case 1A | Turner Test Prep Co. | 103 |
| Case IB | A. Monroe Lock and Security Systems | 105 |
| Case 1C | Beijing Sammies | 108 |
| Case ID | "Mamma Mia!" The Little Show that Could! | 122 |

PART 2 CREATING AND STARTING THE VENTURE 131

| | |
|--|-----|
| CREATIVITY AND THE BUSINESS IDEA | 132 |
| Opening Profile: Frederick W. Smith | 133 |
| Sources of New Ideas | 135 |
| Consumers | 135 |
| Existing Products and Services | 136 |
| Distribution Channels | 136 |
| Federal Government | 136 |
| Research and Development | 136 |
| Methods of Generating Ideas | 137 |
| Focus Groups | 137 |
| Brainstorming | 138 |
| Problem Inventory Analysis | 138 |
| Creative Problem Solving | 139 |
| Brainstorming | 139 |
| Reverse Brainstorming | 140 |
| Brainwriting | 140 |
| Gordon Method | 140 |
| Checklist Method | 141 |
| Free Association | 142 |
| Forced Relationships | 142 |
| Collective Notebook Method | 143 |
| Attribute Listing | 143 |
| Big-Dream Approach | 143 |
| Parameter Analysis | 143 |
| Opportunity Recognition | 144 |
| Product Planning and Development Process | 144 |
| Establishing Evaluation Criteria | 145 |
| Idea Stage | 146 |
| Concept Stage | 147 |
| Product Development Stage | 149 |
| Test Marketing Stage | 150 |
| E-Commerce and Business Start-Up | 150 |
| Using E-Commerce Creativity | 150 |
| Website | 151 |

| | | | |
|---|---|-----|-----|
| | Tracking Customer Information | 152 | |
| | Doing E-Commerce as an Entrepreneurial Company | 152 | |
| 6 | LEGAL ISSUES FOR THE ENTREPRENEUR | | 158 |
| | Opening Profile: Daniel Schreiber | 159 | |
| | What Is Intellectual Property? | 160 | |
| | Need for a Lawyer | 160 | |
| | How to Select a Lawyer | 161 | |
| | Legal Issues in Setting Up the Organization | 161 | |
| | Patents | 161 | |
| | International Patents | 163 | |
| | The Disclosure Document | 164 | |
| | The Patent Application | 164 | |
| | Patent Infringement | 165 | |
| | Business Method Patents | 166 | |
| | Trademarks | 166 | |
| | Registering the Trademark | 167 | |
| | Copyrights | 168 | |
| | Trade Secrets | 170 | |
| | Licensing | 172 | |
| | Product Safety and Liability | 174 | |
| | Insurance | 175 | |
| | Contracts | 177 | |
| 7 | THE BUSINESS PLAN: CREATING AND STARTING THE VENTURE | | 184 |
| | Opening Profile: Belinda Guadarrama | 185 | |
| | Planning as Part of the Business Operation | 186 | |
| | What Is the Business Plan? | 187 | |
| | Who Should Write the Plan? | 187 | |
| | Scope and Value of the Business Plan—Who Reads the Plan? | 188 | |
| | How Do Potential Lenders and Investors Evaluate the Plan? | 189 | |
| | Presenting the Plan | 191 | |
| | Information Needs | 192 | |
| | Market Information | 192 | |
| | Operations Information Needs | 195 | |
| | Financial Information Needs | 195 | |
| | Using the Internet as a Resource Tool | 196 | |
| | Writing the Business Plan | 196 | |
| | Introductory Page | 197 | |
| | Executive Summary | 197 | |
| | Environmental and Industry Analysis | 199 | |
| | Description of Venture | 200 | |
| | Production Plan | 202 | |
| | Operations Plan | 204 | |
| | Marketing Plan | 204 | |
| | Organizational Plan | 204 | |
| | Assessment of Risk | 205 | |

| | | |
|----------|--|------------|
| | Financial Plan | 205 |
| | Appendix | 206 |
| | Using and Implementing the Business Plan | 206 |
| | Measuring Plan Progress | 207 |
| | Updating the Plan | 207 |
| | Why Some Business Plans Fail | 208 |
| 8 | THE MARKETING PLAN | 218 |
| | Opening Profile: Michael S. Dell | 219 |
| | Industry Analysis | 221 |
| | Competitor Analysis | 221 |
| | Marketing Research for the New Venture | 222 |
| | Step One: Defining the Purpose or Objectives | 223 |
| | Step Two: Gathering Data from Secondary Sources | 223 |
| | Step Three: Gathering Information from Primary Sources | 223 |
| | Step Four: Analyzing and Interpreting the Results | 226 |
| | Understanding the Marketing Plan | 226 |
| | Characteristics of a Marketing Plan | 227 |
| | The Marketing Mix | 230 |
| | Steps in Preparing the Marketing Plan | 231 |
| | Defining the Business Situation | 231 |
| | Defining the Target Market/Opportunities and Threats | 231 |
| | Considering Strengths and Weaknesses | 233 |
| | Establishing Goals and Objectives | 234 |
| | Defining Marketing Strategy and Action Programs | 234 |
| | Marketing Strategy: Consumer versus Business-to-Business Markets | 238 |
| | Budgeting the Marketing Strategy | 240 |
| | Implementation of the Market Plan | 240 |
| | Monitoring Progress of Marketing Actions | 240 |
| | Contingency Planning | 240 |
| | Why Some Plans Fail | 240 |
| 9 | THE ORGANIZATIONAL PLAN | 248 |
| | Opening Profile: Starbucks | 249 |
| | Developing the Management Team | 250 |
| | Legal Forms of Business | 251 |
| | Ownership | 251 |
| | Liability of Owners | 252 |
| | Costs of Starting a Business | 253 |
| | Continuity of Business | 254 |
| | Transferability of Interest | 254 |
| | Capital Requirements | 255 |
| | Management Control | 255 |
| | Distribution of Profits and Losses | 256 |
| | Attractiveness for Raising Capital | 256 |
| | Tax Attributes of Forms of Business | 256 |
| | Tax Issues for Proprietorship | 258 |
| | Tax Issues for Partnership | 258 |
| | Tax Issues for Corporation | 259 |

The Limited Liability Company versus the S Corporation 259
 S Corporation 259
 Advantages of an S Corporation 260
 Disadvantages of an S Corporation 260
 The Limited Liability Company 260
 Advantages of an LLC 261
 Designing the Organization 261
 Building the Management Team and a Successful Organization Culture 264
 The Role of a Board of Directors 265
 The Board of Advisors 267
 The Organization and Use of Advisors 267

10 THE FINANCIAL PEAN 274

Opening Profile: Bill Porter—E*TRADE and ISE 275
 Operating and Capital Budgets 277
 Pro Forma Income Statements 278
 Pro Forma Cash Flow 282
 Pro Forma Balance Sheet 285
 Break-Even Analysis 287
 Pro-Forma Sources and Applications of Funds 288
 Software Packages 290

CASES FOR PART 2

Case 2A Bizland, Inc. 295
Case 2B The Beach Carrier 301
Case 2C Gourmet to Go 304
Case 2D Intervela d.o.o. Koper—Victory Sailmakers 311

PART 3 FINANCING THE NEW VENTURE 319

11 SOURCES OF CAPITAL 320

Opening Profile: Walt Disney 321
 An Overview 323
 Debt or Equity Financing 323
 Internal or External Funds 324
 Personal Funds 326
 Family and Friends 327
 Commercial Banks 328
 Types of Bank Loans 328
 Cash Flow Financing 329
 Bank Lending Decisions 330

| | |
|---|-----|
| Role of SBA in Small Business Financing | 331 |
| Research and Development Limited Partnerships | 332 |
| Major Elements | 332 |
| Procedure | 333 |
| Benefits and Costs | 333 |
| Examples | 334 |
| Government Grants | 334 |
| Procedure | 335 |
| Private Placement | 336 |
| Types of Investors | 336 |
| Private Offerings | 336 |
| Regulation D | 337 |
| Bootstrap Financing | 340 |

12 **INFORMAL RISK CAPITAL AND VENTURE CAPITAL** 346

| | |
|--|-----|
| Opening Profile: Tom Kitchin | 347 |
| Financing the Business | 348 |
| Informal Risk-Capital Market | 350 |
| Venture Capital | 353 |
| Nature of Venture Capital | 353 |
| Overview of the Venture-Capital Industry | 353 |
| Venture-Capital Process | 359 |
| Locating Venture Capitalists | 362 |
| Approaching a Venture Capitalist | 362 |
| Valuing Your Company | 364 |
| Factors in Valuation | 365 |
| Ratio Analysis | 366 |
| Liquidity Ratios | 366 |
| Activity Ratios | 366 |
| Leverage Ratios | 367 |
| Profitability Ratios | 367 |
| General Valuation Approaches | 368 |
| General Valuation Method | 370 |
| Evaluation of an Internet Company | 370 |
| Deal Structure | 372 |

CASES FOR PART 3

| | | |
|----------------|----------------------------------|-----|
| Case 3A | The Winslow Clock Company | 378 |
| Case 3B | NeoMed Technologies | 387 |
| Case 3C | Rug Bug Corporation | 402 |
| Case 3D | Nature Bros. Ltd. | 413 |

| | | |
|---------------|--|------------|
| PART 4 | MANAGING, GROWING, AND ENDING THE NEW VENTURE | 421 |
| 13 | ENTREPRENEURIAL STRATEGY: GENERATING AND EXPLOITING NEW ENTRIES | 422 |
| | Opening Profile: Justin Parer | 423 |
| | New Entry | 424 |
| | Generation of a New Entry Opportunity | 425 |
| | Resources as a Source of Competitive Advantage | 425 |
| | Creating a Resource Bundle That Is Valuable, Rare, and Inimitable | 426 |
| | Assessing the Attractiveness of a New Entry Opportunity | 429 |
| | Information on a New Entry | 429 |
| | Comfort with Making a Decision under Uncertainty | 430 |
| | Decision to Exploit or Not to Exploit the New Entry | 430 |
| | Entry Strategy for New Entry Exploitation | 431 |
| | Environmental Instability and First-Mover (Dis)Advantages | 433 |
| | Customers' Uncertainty and First-Mover (Dis)Advantages | 435 |
| | Lead Time and First-Mover (Dis)Advantages | 437 |
| | Risk Reduction Strategies for New Entry Exploitation | 438 |
| | Market Scope Strategy | 439 |
| | Imitation Strategies | 440 |
| | Managing Newness | 442 |
| 14 | STRATEGIES FOR GROWTH AND MANAGING THE IMPLICATIONS OF GROWTH | 450 |
| | Opening Profile: Brian and Jennifer Maxwell | 451 |
| | Growth Strategies: Where to Look for Growth Opportunities | 452 |
| | Penetration Strategies | 453 |
| | Market Development Strategies | 454 |
| | Product Development Strategies | 454 |
| | Diversification Strategies | 455 |
| | Example of Growth Strategies | 456 |
| | Economic Implications of Growth | 458 |
| | Implications of Growth for the Firm | 459 |
| | Pressures on Existing Financial Resources | 460 |
| | Pressures on Human Resources | 460 |
| | Pressures on the Management of Employees | 460 |
| | Pressures on the Entrepreneur's Time | 460 |
| | Overcoming Pressures on Existing Financial Resources | 460 |
| | Financial Control | 461 |
| | Managing Cash Flow | 461 |
| | Managing Inventory | 462 |
| | Managing Fixed Assets | 465 |
| | Managing Costs and Profits | 465 |
| | Taxes | 468 |
| | Record Keeping | 468 |

| | | |
|-----------|---|------------|
| | Overcoming Pressures on Existing Human Resources | 469 |
| | Overcoming Pressures on the Management of Employees | 470 |
| | Overcoming Pressures on Entrepreneurs' Time | 472 |
| | Basic Principles of Time Management | 473 |
| | Implications of Firm Growth to the Entrepreneur | 474 |
| | A Categorization of Entrepreneurs and Their Firms' Growth | 475 |
| 15 | ACCESSING RESOURCES FOR GROWTH FROM EXTERNAL SOURCES | 482 |
| | Opening Profile: Bill Gross | 483 |
| | Using External Parties to Help Grow a Business | 484 |
| | Franchising | 485 |
| | Advantages of Franchising—to the Franchisee | 485 |
| | Advantages of Franchising—to the Franchisor | 487 |
| | Disadvantages of Franchising | 488 |
| | Types of Franchises | 488 |
| | Investing in a Franchise | 489 |
| | Joint Ventures | 493 |
| | Types of Joint Ventures | 493 |
| | Factors in Joint Venture Success | 494 |
| | Acquisitions | 495 |
| | Advantages of an Acquisition | 495 |
| | Disadvantages of an Acquisition | 496 |
| | Synergy | 497 |
| | Structuring the Deal | 497 |
| | Locating Acquisition Candidates | 497 |
| | Mergers | 498 |
| | Leveraged Buyouts | 499 |
| | Overcoming Constraints by Negotiating for More Resources | 500 |
| 16 | GOING PUBLIC | 510 |
| | Opening Profile: Sam Walton | 511 |
| | Advantages and Disadvantages of Going Public | 513 |
| | Advantages | 513 |
| | Disadvantages | 514 |
| | The Alternatives to Going Public | 517 |
| | Timing of Going Public and Underwriter Selection | 519 |
| | Timing | 519 |
| | Underwriter Selection | 520 |
| | Registration Statement and Timetable | 521 |
| | The Prospectus | 523 |
| | Part II | 524 |
| | Procedure | 524 |
| | Legal Issues and Blue-Sky Qualifications | 526 |
| | Legal Issues | 526 |
| | Blue-Sky Qualifications | 527 |

After Going Public 527
 Aftermarket Support 527
 Relationship with the Financial Community 527
 Reporting Requirements 528
Myths concerning Going Public 528

17 ENDING THE VENTURE 534

**Opening Profile: Adelphia Communications Corporation—
William Schleyer** 535
Bankruptcy—An Overview 536
Chapter 11—Reorganization 539
 Surviving Bankruptcy 540
 Prepackaged Bankruptcy 541
Chapter 13—Extended Time Payment Plans 541
Chapter 7—Liquidation 542
Strategy during Reorganization 542
Keeping the Venture Going 543
Warning Signs of Bankruptcy 545
Starting Over 545
The Reality of Failure 546
Business Turnarounds 547
Exit Strategy 548
Succession of Business 548
 Transfer to Family Members 549
 Transfer to Non-Family Members 549
Harvesting Strategy 551
 Direct Sale 551
 Employee Stock Option Plan 552
 Management Buyout 552

CASES FOR PART 4

Case 4A Oklahoma National Bank 558
Case 4B Datavantage Corporation 567
Case 4C Dual Pane Company 578

INDEX 581