Springer Texts in Business and Economics

Robert D. Hisrich
Veland Ramadani

Effective Entrepreneurial Management

Strategy, Planning, Risk Management, and Organization

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To my spouse Tina, children Kary, Katy, and Kelly, my sons-in-law Rich and Kevin, and grandchildren Andrew, Rachel, and Sarah.

Robert D. Hisrich

To my spouse Lindita and my sons Rron and Rrezon

Veland Ramadani

Preface

Starting and managing a new business involves considerable risk and effort to overcome the problems in creating and growing a new venture. These problems are so great that in the USA, about 80–85% of all new ventures are bought or folded into another company or fail (file for bankruptcy) within the first 5 years of their existence. For entrepreneurs to flourish and for new organizations to be created, four elements are required: an infrastructure that is supportive, an idea with unique value propositions, capital to get started and grow, and an entrepreneur to work toward making the venture a reality. For an enterprise to thrive in the long run, the entrepreneur needs to overcome several challenges and be prepared at every stage as in the start. This book introduces and discusses these elements to help you as an entrepreneur or small business manager avoid any negative outcomes and successfully manage and grow a business.

The interest of consumers, businesspeople, and government officials from every part of the world in entrepreneurship is evident from the increasing research on the subject, the large number of courses and seminars on the topic, the more than two million new enterprises started each year (despite a 70% failure rate), the significant coverage and focus by the media, and the realization that this is an important aspect of the economics of the developed, developing, and even controlled economies.

To provide an understanding of the entrepreneurial manager and the process of creating and growing a new venture, this book—*Effective Entrepreneurial Management*—is divided into 11 chapters.

Chapter 1—*Foundation of entrepreneurial management*—introduces the entrepreneurial management and the entrepreneurial process from both the historical and research perspectives. The private, public, corporate, and social entrepreneurs are compared to provide an understanding of different mind-sets required for different sectors entrepreneurship. This chapter also discusses on managerial versus entrepreneurial decision-making process and examines the steps in the entrepreneurial process for an effective entrepreneurial management.

Chapter 2—*Entrepreneurial business planning*—presents an overview of the importance of a business plan as well as its scope and value. This chapter discusses the information needs for developing a good business plan, the use and implementation of the business plan, and the reason for failure. The chapter continues with a detailed explanation of each element of business plan and provides directions to aspiring entrepreneurs about the outline and content.

Chapter 3—*Creativity, innovation and entrepreneurial manager*—examines the ways organizations can prosper through creativity and innovation. Creativity and innovation are discussed by providing an understanding of the aspects of creativity and its contribution to innovation. The creative process is discussed along with some creative problem-solving techniques. This chapter concludes with a discussion on the link between creativity and innovation and a discussion of various aspects and forms of innovation.

Chapter 4—*Entrepreneurial risk management*—focuses on risks and risk management. As the risk is defined, the chapter continues with discussion of types of risk. Characteristics of risk management are then discussed along with five major risk management phases—context definition, risk identification, risk analysis, risk treatment, and risk monitoring and reviewing. The chapter ends with risk evaluation strategies—risk avoidance, risk reduction, risk anticipation, risk transfer, and risk acceptance.

Chapter 5—*Entrepreneurial marketing mix*—discusses about entrepreneurial marketing activities as essential for every new or established business. This chapter focuses on the marketing tools, such as product, price, place (distribution), and promotion. Then, the differences and similarities of traditional and entrepreneurial marketing elements and contents are discussed. The chapter concludes with a discussion of basic forms of entrepreneurial marketing such as guerrilla, ambush, buzz, and viral marketing.

Chapter 6—*Organizing an entrepreneurial venture*—focuses on the legal form of the organization and the organizational structure of the new venture. The chapter begins with a discussion of the reasons for selecting one legal form over alternative forms. Then, the chapter focuses on the legal forms of business available in the USA. The chapter concludes with a discussion of Board of Advisors or a Board of Directors.

Chapter 7—*Raising capital for the entrepreneurial path*—deals with capitalization of the business introducing the various methods of raising funds for the money like seed fund, crowdfunding, trade credit, business angels, venture capital, banks loans, share offerings, and government. Each of these sources of capitals is examined to provide entrepreneurs the advantages and disadvantages of each. The venture capital process is discussed in detail and the idea about locating venture capitalist is also presented. The chapter concludes by discussing the choice of sources as per the type of enterprise and the goals of the entrepreneur.

Chapter 8—*Entrepreneurial business growth*—focuses on the most important aspect of growing the entrepreneurial businesses by first looking at identifying the main factors that influence the growth followed by the discussion of the main perspectives of growth. Characteristics of fast-growing companies and management actions enabling growth are then discussed along with four major growth strategies—market penetration, market development, product development, and diversification. The chapter concludes with a presentation of some exit options from a company.

Chapter 9—*E-commerce challenges and entrepreneurial manager*—is about e-commerce. The chapter begins with the explanation of the nature of e-commerce, where some definitions of e-commerce, differences between e-commerce and traditional commerce, and differences between pure and partially e-commerce are represented. In other sections, the basic types of e-commerce, benefits from e-commerce, and barriers of e-commerce implementation are discussed.

Chapter 10—*Business ethics, social responsibility and entrepreneurial manager*—focuses on ethical values, standards, and beliefs and their implementation in business. This chapter discusses the situations with an ethical dilemma and how to deal with them. In addition, the factors that affect an ethical behavior and the features of moral, amoral, and immoral managers are explained. The chapter ends with the discussion of the essence of social responsibility, the pyramid of social responsibility, and benefits from action as a socially responsible business.

Chapter 11—*Entrepreneurial family business and succession management*—presents a review of some important issues related to family businesses, such as family business categories, members of family businesses, succession process, family business cultures, conflicts in family businesses, etc.

To make *Effective Entrepreneurial Management*, as meaningful as possible to students, each chapter begins with chapter learning objectives and a profile of an entrepreneur whose career is especially relevant to the chapter material. Numerous business examples occur throughout each chapter. Each chapter concludes with short case studies, class discussion questions, and selected websites for further readings.

Many people—students, business executives, entrepreneurs, professors, and publishing staff—have made this book possible. Our utmost appreciation goes to our assistants and students, Laxman Panthi, Donika Zendeli, Faton Ahmeti, Artiana Ajdini, Diin GraInca, Nermine Shabani, and Mejreme Sinani for providing research material and editorial assistance and without whom this book would have never been prepared in a timely manner.

We are deeply indebted to our spouses, Tina and Lindita, whose support and understanding helped bring this effort to fruition. It is to future entrepreneurs—our children Kary, Katy, Kelly, Rron, and Rrezon and grandchildren Rachel, Andrew, Sarah, and Jack—and the new generation they represent—that this book is particularly dedicated. May you always beg for forgiveness rather than ask permission.

Kent, OH — Robert D. Hisrich
Tetova, Macedonia — Veland Ramadani

Endorsements

A brilliant and inspiring masterpiece—long-awaited contribution to the literature

Léo-Paul Dana
Professor, Montpellier Business School, France
Marie Curie Fellow, Princeton University, USA
Editor of Int. J. Entrepreneurship and Small Business

Hisrich and Ramadani have put together the guide that students need to understand entrepreneurship. They recognize that starting and growing a venture includes both strategy and action. The authors lay out the steps that can lead to success.

Many books are on the market telling students that they need to be creative and innovative in getting a new business up and running. In *Effective Entrepreneurial Management*, Hisrich and Ramadani explain what those terms mean and how to carry them out. This book takes readers through the start-up process as well as what happens next. Business formation is risky and many new ventures fail. Does that really have to happen? Despite what people think, a lot has been learned about what makes a business successful. You don't have to make every mistake other entrepreneurs have made. This book helps you to avoid the mistakes others have made and introduces you to the steps that are more likely to help you achieve your goals.

Hisrich and Ramadani have some advice for you. You don't have to make the mistakes that have led to failure. Read this book and learn the actions that can help you overcome obstacles and build a successful venture.

Frank Hoy
Professor, Director of the Collaborative for Entrepreneurship and Innovation
at Worcester Polytechnic Institute, USA

This book is a long-awaited addition to the entrepreneurship field as it provides a succinct understanding about effective entrepreneurial management. The book covers business planning and the challenges that managers face: how creativity and risk management is conducted? It then explores finance and growth to e-commerce and ethics implications. The last chapter about family business and succession management highlights how important entrepreneurial thinking is for managers in their businesses. I highly recommend this book for entrepreneurs and managers who want a good understanding about the issues they face in their firms.

Vanessa Ratten
Assoc. Professor, Management and Marketing Department,
La Trobe University, Australia

Contents

About the Authors

Robert D. Hisrich is the Bridgestone Chair of International Marketing and Associate Dean of Graduate and International Programs at the College of Business Administration at Kent State University. He holds a B.A. from DePauw University and an M.B.A. and a doctorate from the University of Cincinnati. Professor Hisrich's research pursuits are focused on entrepreneurship and venture creation: entrepreneurial ethics, corporate entrepreneurship, women and minority entrepreneurs, venture financing, and global venture creation. He teaches courses and seminars in these areas, as well as in marketing management and product planning and development. His interest in global management and entrepreneurship resulted in two Fulbright Fellowships in Budapest, Hungary, honorary degrees from Chuvash State University (Russia) and the University of Miskolc (Hungary), and being a visiting faculty member in universities in Austria, Australia, Ireland, and Slovenia. Professor Hisrich serves on the editorial boards of several prominent journals in entrepreneurial scholarship, is on several boards of directors, and is author or coauthor of over 300 research articles appearing in journals such as *Journal of Marketing, Journal of Marketing Research, Journal of Business Venturing, Journal of Developmental Entrepreneurship, and Entrepreneurship Theory and Practice*. Professor Hisrich has authored or coauthored 41 books or their editions, including *Marketing: A Practical Management Approach*, *How to Fix and Prevent the 13 Biggest Problems That Derail Business*, *International Entrepreneurship: Starting, Developing and Managing a Global Venture* (3rd edition), and *Technology Entrepreneurship: Value Creation, Protection, and Capture* (2nd edition).

Veland Ramadani is an Associate Professor at South-East European University, Republic of Macedonia, where he teaches both undergraduate and postgraduate courses in entrepreneurship and small business management. His research interests include entrepreneurship, small business management, family businesses, and venture capital investments. He has authored or coauthored around eighty research articles and fifteen books, including *Entrepreneurship and Management in an Islamic Context*, *Female Entrepreneurship in Transition Economies: Trends and Challenges*, *Family Businesses in Transition Economies: Management, Succession and Internationalization*, *Entrepreneurship in the Balkans: Diversity, Support and Prospects*, *Direct Marketing and Small Business*, *Business Angels* (in Albanian language), *Entrepreneurship and Small Business Management* (in Albanian language), and Venture Capital and Small Business (in Macedonian language). Besides serving as an Associate Editor of *International Journal of Entrepreneurship and Small Business* (IJESB) and *International Journal of Technology Transfer and Commercialisation* (IJTTC), Dr. Ramadani serves on the editorial and review boards of several journals from the field of entrepreneurship and management. Dr. Ramadani received the Award for Excellence 2016—Outstanding Paper by Emerald Group Publishing (*Journal of Enterprising Communities: People and Places in the Global Economy*).

Foundation of Entrepreneurial Management

1

Learning Objectives
After reading this chapter, you should be able to:

- Understand entrepreneurship and the entrepreneur.
- Understand the different types of entrepreneurship (public sector, private sector, corporate, social).
- Know the principle of entrepreneurial management.
- Know the differences between entrepreneurial and traditional managers.
- Understand the characteristics of an entrepreneurial mindset.

Profile: Gordon Butch Stewart
Gordon Butch Stewart, born in Kingston, Jamaica, on July 6, 1941, has been hailed by many as the "King of All-Inclusive Resorts," the "Cupid of the Caribbean," and the "Master of Marketing". While all descriptions are appropriate, none of them quite capture the full measure of Gordon "Butch" Stewart, founder and chairman of Sandals and Beaches Resorts.

How could a simple phrase define a man who today controls what analyst's estimate to be a billion dollar, privately-owned Jamaican-based empire that includes 18 Caribbean resorts, the Appliance Traders Ltd., and The Jamaica Observer newspaper.

All told, Butch Stewart spearheads two-dozen diverse companies that are collectively Jamaica's largest private sector group, the country's biggest foreign exchange earner, and its largest non-government employer. Mr. Stewart began his career at the Dutch-owned Curacao Trading Company,

(continued)

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where he earned enough in five years as a sales manager to open his own air-conditioner service and distribution business in 1968.

With £5000 he established Appliance Traders Limited (ATL) in a building leased from Pat and Peter Rousseau's Key Homes at Caledonia Avenue, Cross Roads, refurbished it and set a blistering path, with Fedders air-conditioning units as its trump card.

That company, Appliance Traders Ltd., expanded rapidly and now sells a wide assortment of household and commercial appliances and supplies. But Stewart was just getting started. In 1981, he bought the Montego Bay property that launched his wildly successful couples-only Sandals Resorts chain. And today, he oversees a billion-dollar, 9000-employee empire that includes 12 Sandals Resorts, six other high-end Caribbean vacation properties, Appliance Traders and a leading Jamaican daily newspaper.

Altogether, he owns and operates two dozen companies that collectively constitute his country's largest private-sector group, biggest foreign-exchange earner and largest non-government employer. Mr. Stewart was a recipient of Caribbean World Magazine's Lifetime Achievement Award for his work in Jamaica, and has been called one of Jamaica's most-admired businessmen.

Source: This profile is written by the authors based on the information in: http://enterprisestlucia.org/inspiration/entrepreneur-profiles/gordon-butch-stewart/; http://www.reallife.ky/editorial/mr-jamaica-gordon-butch-stewart.

1.1 Introduction

As organizations, industries, and consumers become more dynamic, effective entrepreneurial management becomes more important. While entrepreneurship has traditionally been viewed as a private sector phenomenon, corporate, government and social entrepreneurship have developed in a number of different domains such as not-for-profits, for-profits, and public sector organizations. Entrepreneurship is a universal concept and can be applied in small and medium-sized enterprises (SMEs), large national and multinational organizations, as well as in social ventures, enterprises, communities, and governments. Entrepreneurship is not limited to a select group of people; any per-son with the right mindset, drive, and motivation can develop an entrepreneurial perspective. This perspective identifies a need and transforms this need it from a creative and innovative idea into reality.

In most industries, nations, and markets, effective entrepreneurial management challenges existing assumptions and look to generate value in more innovative and creative ways. Effective entrepreneurial management changes the way business is conducted by identifying opportunities and successfully filling them. Since organizations need to renew themselves in order to sustain competitiveness, this can take such forms as championing innovative ideas, providing necessary resources or expertise, or institutionalizing the entrepreneurial activity within the organization’s systems and processes.

This chapter develops an understanding of effective entrepreneurial management and the historical perspectives on entrepreneurship by analyzing the concept of private entrepreneurship, government entrepreneurship (governpreneurship) corporate entrepreneurship, and social entrepreneurship. The nature of the entrepreneurial process is then explored along with how it applies within established organizations. Entrepreneurship is a unifying framework for successful effective entrepreneurial management that can be achieved by combining the key activities of managers and entrepreneurs.

1.2 Overview of Entrepreneurship

The term entrepreneurship means different things to different individuals. Even though entrepreneurship has become its own area of study, there remains several questions: Who is an entrepreneur? What is entrepreneurship? What is corporate entrepreneurship? What is social entrepreneurship? What is the entrepreneurial process? These frequently asked questions reflect the increased national and international interest in entrepreneurs and entrepreneurship by individuals, groups, academics, students, and government officials. The development of the theory of entrepreneurship parallels to a great extent the development of the term itself. The word entrepreneur is French and, literally translated, means “between-taker” or “go-between.”

1.2.1 Entrepreneur and Entrepreneurship

An early definition and example of an entrepreneur as a go-between is Marco Polo, who attempted to establish trade routes to the Far East. In the Middle Ages, the term entrepreneur was used to describe both an actor and a person who managed large production projects. For example, a person in charge of architectural works, such as castles, public buildings, and cathedrals, was considered the entrepreneur. In such large production projects, this individual did not take any risks but rather managed the project using the resources provided by the government of the country.

In the seventeenth century, an entrepreneur was a person who entered into a contractual arrangement with the government to perform a service or to supply stipulated products. For example, John Law, a Frenchman, was allowed to establish a royal bank. Richard Cantillon, in the 1700s, developed one of the early theories of the entrepreneur describing the entrepreneur as a risk taker and a rational decision maker who assumed the risk and provided management for the firm.

In the eighteenth century, the entrepreneur was distinguished from the capital provider. Many of the inventions developed during this time were reactions to the needs of the changing world, as was the case with the inventions of Eli Whitney (cotton gin) and Thomas Edison (light bulb).

In the late nineteenth and early twentieth centuries, entrepreneurs were frequently not distinguished from managers and were viewed mostly from an economic perspective. Some believed that the key factor in distinguishing a manager from an entrepreneur was the bearing of risk. An example of this type of entrepreneur is Andrew Carnegie, who in-vented nothing but rather adapted and developed new technology in the creation of products to achieve economic vitality in the steel industry. In the middle of the twentieth century, the notion of an entrepreneur as an innovator was established along with a more refined definition.

The concept of innovation and newness became an integral part of entrepreneurship in the mid-twentieth century. Innovation, the act of introducing something new and relevant, is one of the most difficult tasks for the entrepreneur. It takes not only the ability to create and conceptualize, but also the ability to understand all the forces at work in the environment. John Pierpont Morgan, who developed his large banking house by reorganizing and financing industries, is an example of this type of entrepreneur.

The term entrepreneurship has historically referred to the efforts of an individual who takes on the odds in translating a vision into a successful business enterprise. While some definitions focus on the creation of new organizations, others focus on wealth creation and ownership. The concept of an entrepreneur is further refined through the principles and terms from a business, managerial, and personal perspective. The concept of entrepreneurship from a personal perspective is reflected in three behavioral attributes of an entrepreneur: (1) initiative taking, (2) organizing and reorganizing of social and economic mechanisms to turn resources and situations to practical account, and (3) acceptance of risk or failure.

To an economist, an entrepreneur is one who brings resources, labor, vision, materials, and other assets into combinations that increase product or service value and introduce and implement change, innovation, and a new order. To a psychologist, such a person is typically driven by certain forces—the need to attain something, to experiment, to accomplish, or perhaps to escape authority. To one businessperson, an entrepreneur may appear as a threat, an aggressive competitor, whereas to another businessperson the same entrepreneur may be an ally, a supplier, a customer, or a creator of wealth. The entrepreneurial manager finds better ways to utilize resources, reduce waste, and produce jobs for willing candidates.

Entrepreneurship is the dynamic process of creating incremental wealth and stimulating the surrounding environment. The wealth is created by individuals who assume the major risks in terms of equity, time, and career commitment by providing value for a product or service. The product or service can have varying degrees of newness but needs to be infused by the entrepreneur regardless of its degree.

While the descriptions have slightly different views of the entrepreneur, they also contain similar notions, such as newness, organizing, creating wealth, and risk taking. Yet these definitions are somewhat restrictive, since entrepreneurs are found in all professions—education, medicine, research, law, architecture, engineering, social work, distribution, and government. To include all types of entrepreneurial behavior, there is a need for an all-inclusive definition: Entrepreneurship is the process of creating something new with value by devoting the necessary time and effort assuming the accompanying financial, psychic, and social risks and uncertainties; and receiving the resulting rewards of monetary and personal satisfaction.

1.3 Corporate Entrepreneurship

Corporate entrepreneurship, which is sometimes referred to as intrapreneurship or corporate venturing, is the process by which individuals inside organizations pursue opportunities independent of the resources they currently control; this involves doing new things and pursuing new opportunities. The spirit of entrepreneurship within an existing organization results in the creation of a new organization or in the development of renewal and innovation within that organization. Corporate entrepreneurship requires engendering entrepreneurial behaviors within an established organization. It can be viewed as a system that enables individuals to use creative processes for applying and inventing.

Corporate entrepreneurship involves extending the organization's degree of competence and corresponding opportunity through internally generated new resource combinations. Organizations can foster innovations by encouraging employees to think like entrepreneurs and then giving them the freedom and flexibility to pursue projects without being inhibited by bureaucratic barriers. Internal generation of innovation influenced by organizational and environmental characteristics requires motivated individuals and groups and an open, conducive environment. Companies such as IBM, Hewlett-Packard (HP), 3M, Apple, Facebook, Microsoft, and Xerox have also experienced significant success in corporate entrepreneurship. A broad definition of corporate entrepreneurship emphasizes that corporate entrepreneurship encompasses two major phenomena: new venture creation within existing organizations and the transformation of organizations through strategic renewal (Guth & Ginsberg, 1990). This renewal usually involves formal or informal activities aimed at creating new businesses or processes in established organizations at the corporate, division, functional, or project levels. The ultimate aim of the renewal is to improve a company's competitive position and financial performance. Renewal is achieved through the redefinition of an organization's mission through the creative redeployment of resources, leading to new combinations of products and technologies. Corporate entrepreneurship in terms of renewal emphasizes strategy reformulation, reorganization, and organizational change.

1.4 Public Sector Entrepreneurship

Public sector organizations are often large, hierarchical entities facing captive demand, enjoying somewhat guaranteed sources and levels of financing, and having some distance from the influences of voters, stake-holders and political institutions. The more the government organization is bureaucratic and conservative, the less entrepreneurial government employees are apt to be. As a result of the global economy, governments are increasingly looking to foster entrepreneurial thinking and activity. Some governments are now attempting to realign their public sectors with the changing global environment. They are emphasizing new "public managerialism" and discontinuous reforms that challenge traditional mindsets and include the need for innovation and entrepreneurship.

Lee Kuan Yew, the first Prime Minister of Singapore following Singapore's declaration of independence in 1959, faced the task of transforming the small island nation into an independent and self-sustaining economy. The Prime Minister innovatively pursued a series of economic policies that did not follow the tradition of forging trade relations with neighboring countries. Instead, he pursued an aggressive campaign to attract new resources into the nation through foreign direct investment. The legacy of Lee's entrepreneurial approach to economic development continues to attract vast amounts of economic wealth into Singapore.

Private sector organizations are affected by their external environment. One aspect of this that has been the rapidly changing is the nature of the relationships between public officials and their constituencies. Entrepreneurial behavior is now viewed as one way to develop innovative solutions to satisfy the needs and expectations of their constituencies.

Public sector entrepreneurship is similar to some extent to entrepreneurship in large corporations—corporate entrepreneurship. The public sector and large corporations often have formalized hierarchies, established stakeholder groups with competing demands, deeply entrenched cultures, detailed rules and procedures, and a fairly rigid system of financial controls, budgeting and employee rewards. Managers in the public sector and large corporations focus more on internal developments and on the actual process than the outcome, which can inhibit entrepreneurship and innovation.

The entrepreneur is creative, proactive and innovative. This provides innovation through identifying and developing opportunities. Successful entrepreneur and entrepreneurial activities are unique in public sector organizations with larger, hierarchical and more rigid organizations. A good definition of this individual in the public sector is:

> *Public sector entrepreneurship is an individual or group of individuals undertaking activities to initiate change by adapting, innovating and assuming risk, and recognizing that personal goals and objectives are less important than generating results for the organization.*

1.4.1 Differences Between Public and Private Sector Entrepreneurship

A comparison of the three types entrepreneurs in the private sector, corporate, and public sector is indicated in Table 1.1. Public sector entrepreneurs need to

Table 1.1 Comparison of private, corporate, and public entrepreneurs

	Private (independent) entrepreneurs	Corporate entrepreneurs	Public sector entrepreneur
Objectives	Freedom to discover and exploit profitable opportunities; independent and goal oriented; high need for achievement	Requires freedom and flexibility to pursue projects without being bogged down in bureaucracy; goal oriented; independently motivated but is influenced by the corporate characteristics	An individual who is motivated by power and achievement; undertakes purposeful activity to initiate, maintain or aggrandize, one or more public sector organizations; not constrained by profit
Focus	Strong focus on the external environment; competitive environment and technological advancement	Focus on innovative activities and orientations such as development of new products, services, technologies, administrative techniques, strategies, and competitive postures; primary focus is economic returns generated through innovation	Aims to create value for citizens by bringing together unique combinations of public and/or private resources to exploit social opportunities; learns to use external forces to initiate and achieve internal change.
Innovation	Create value through innovation and seizing that opportunity without regard to resources (human and capital); produces resources or endows existing resources with enhanced potential for creating wealth	A system that enables and encourages individuals to use creative processes that enable them to apply and invent technologies that can be planned, deliberate, and purposeful in terms of the level of innovative activity desired; instigation of renewal and innovation within that organization	Creates practical, innovative, and sustainable approaches to social problems for the benefit of society in general; mobilizes ideas and resources required for social transformation
Opportunity	Pursues an opportunity, regardless of the resources it controls; relatively unconstrained by situational forces	Pursues opportunities independent of the resources it currently controls; doing new things and departing from the customary to pursue opportunities	Shows a capacity to recognize and take advantage of opportunities to create social value by stimulating social change; develops a social value proposition to challenge equilibrium
Risk taking	Risk taking is a primary factor in the entrepreneurial character and function;	Calculated risk taker; recognizes that risks are career related and	Recognizes the social value of creating opportunities and key decision making

(continued)

Table 1.1 (continued)

	Private (independent) entrepreneurs	Corporate entrepreneurs	Public sector entrepreneur
	assumes significant personal and financial risk but attempts to minimize it	absorbed by organization as a whole	characteristics of innovation, proactivity, and risk taking; accepts an above average degree of risk
Character and skills	Self-confident; strong business knowledge; independent	Self-confident; strong self-belief in ability to manipulate the system; strong technical or product knowledge; good managerial skills	Self-confident; high tolerance for ambiguity; strong political skills

Source: Authors' own table based on Kearney, Hisrich, and Roche (2008)

understand this political authority when designing and implementing policies. Public sector entrepreneurs need to be civic-minded and have the public interest in mind. In the case of Singapore, this is exemplified by a 'top-down' approach to entrepreneurship, a strategic approach that includes: governmental policies to reduce barriers to foreign direct investment, subsidies for firms or researchers in targeted industries, emphasis on creative thinking and 'think tanks' at public universities, and the recruitment of foreign professionals into the state to mentor the next generation and fuel entrepreneurial growth in the business sector.

Some of the differences between the public and private sectors are that the public sector:

- has greater diversity and conflicting, multiple objectives;
- has lower scores on organizational commitment and job satisfaction;
- can be lower in prestige and social status;
- has less decision-making autonomy and flexibility, and more constraints;
- has a higher concentration of authority with established centralized procedures;
- has lower incentives;
- has salaried managers who do not share in the organization's profits;
- is not constrained by the profit motive of the private sector;
- can more easily obtain large amounts of funding; and
- is free of any private enterprise restrictions.

These differences in public sector entrepreneurs reflect the following differences between public and private sector organizations:

- have no profit motive but instead social and political objectives;
- receive funds indirectly from an involuntary taxpayer;
- have problems in identifying the organization's stakeholders and constituencies; and

- are subject to public scrutiny.

Entrepreneurship in the public sector, unlike the private sector, relies less on particular individual attributes and more on a group desire. Personal qualities and motivations become less important than being able to operate at the institutional level. There are key differences with respect to the level of diversity in objectives, diversity in decision making, authority, risk/rewards, motivation, availability of funding, different restrictions in growth and levels of independence (Kearney et al., 2008).

1.5 Social Entrepreneurship

Definitions of social entrepreneurship are much more limited and diverse than those for corporate entrepreneurship. While the term entrepreneurship is mostly associated with private sector activity, in the last 20 years, the value creation aspect of entrepreneur-ship has been extended to social organizations. Social entrepreneurship has made significant contributions to communities and society in general by adopting business models to offer innovative and creative solutions to complex social issues. Despite increased interest in social entrepreneurship and the credence of the growing impact of social entrepreneurship as evidenced in Fast Company Magazine's Social Capitalist Awards and the Skoll Foundation's Awards for Social Entrepreneurship, there has been limited re-search in the area. One challenge is that the definition of social entrepreneurship has been developed in a number of different domains such as not-for-profits, for-profits, public sector organizations, and a combination of the three. Social entrepreneurship can be broadly defined as innovative activity with a social objective in the for-profit sector, such as social commercial ventures; nonprofit sector; public sec-tor; or even across sectors in terms of hybrid organizations that combine for-profit and nonprofit approaches.

Social entrepreneurship can be more narrowly defined as the application of business expertise and market skills in the for-profit, nonprofit, or public sector when these organizations develop more innovative approaches in business activities. Common across all definitions of social entrepreneurship is that its core objective is to create social value rather than personal and stakeholder wealth.

Even though all of the above definitions of entrepreneurship, public sector entrepreneurship, corporate entrepreneurship, and social entrepreneurship have slightly different perspectives, they contain similar concepts since entrepreneurship involves creative activity. The core components of entrepreneurship involve the discovery and exploitation of opportunities. In fact, an entrepreneurial event cannot occur without identifying and addressing an opportunity.

Table 1.2 depicts a typology that identifies the similarities and differences between the three types of entrepreneurship and entrepreneurs: private sector, corporate, and social. This table indicates that entrepreneurship and entrepreneurs are characterized as having a preference for creating activity, manifested by some

Table 1.2 Similarities and differences among private, corporate, and social entrepreneurs and entrepreneurship

	Private entrepreneurs/ entrepreneurship	Corporate entrepreneurs/ entrepreneurship	Social entrepreneurs/ entrepreneurship
Objectives	Freedom to discover and exploit profitable opportunities; independent and goal orientated; high need for achievement	Freedom and flexibility to pursue projects without being bogged down in bureaucracy; goal orientated; independently motivated but also influenced by the corporate characteristics	Freedom and resources to serve constituencies; add value to existing services; address social problems and enrich communities and societies; driven by the desire for social justice
Opportunity	Pursues an opportunity, regardless of the resources it controls; relatively unconstrained by situational forces	Pursues opportunities independent of the resources it currently controls; doing new things and departing from the customary to pursue opportunities	Shows a capacity to recognize and take advantage of opportunities to create social value by stimulating social change; develops a social value proposition to challenge equilibrium
Focus	Strong focus on the external environment; competitive environment and technological advancement; primary focus is on financial returns, profit maximization, and independence	Focus on innovative activities and orientations such as development of new products, services, technologies, administrative techniques, strategies, and competitive postures; primary focus is economic returns generated through innovation	Aims to create value for citizens by focusing on serving long-standing needs more effectively through innovation and creativity; aims to exploit social opportunities and enhance social returns, social wealth, social justice
Innovation	Create value through innovation and seizing that opportunity without regard to resources (human and capital); produces resources or endows existing resources with enhanced potential for creating wealth	A system that enables and encourages individuals to use creative processes that enable them to apply and invent technologies that can be planned, deliberate, and purposeful in terms of the level of innovative activity desired; instigation of renewal and innovation within that organization	Creates practical, innovative, and sustainable approaches to social problems for the benefit of society in general; mobilizes ideas and resources required for social transformation

(continued)

Table 1.2 (continued)

	Private entrepreneurs/ entrepreneurship	Corporate entrepreneurs/ entrepreneurship	Social entrepreneurs/ entrepreneurship
Risk taking	Risk taking is a primary factor in the entrepreneurial character and function; assumes significant personal and financial risk but attempts to minimize it	Calculated risk taker; recognizes that risks are career related and absorbed by organization as a whole	Recognizes the social value of creating opportunities and key decision making characteristics of innovation, proactivity, and risk taking; accepts an above average degree of risk
Character and skills	Self-confident; strong business knowledge; independent	Self-confident; strong self-belief in ability to manipulate the system; strong technical or product knowledge; good managerial skills	Self-confident; high tolerance for ambiguity; strong political skills

Source: Authors' own table based on Hisrich and Kralik (2016)

degree of proactiveness and innovativeness. The core components of entrepreneurship include the discovery and exploitation of opportunities. These issues broadly are discussed in Hisrich and Kralik (2016).

1.6 Entrepreneur Versus Manager

There is some confusion about the nature of an entrepreneur versus a manager. Although the entrepreneur is different from the traditional manager, entrepreneurship represents a mode of management. Management involves achieving the objectives of an organization while reducing variability to increase stable processes. It involves accomplishing work through people. To manage effectively means to forecast, plan, organize, coordinate, communicate, lead, facilitate, motivate, and control. Management is the transformation of inputs into outputs through conceptual, human, and technical skills. Managers are required to efficiently and effectively utilize resources to achieve optimum results in line with organizational goals and objectives.

An entrepreneur is future orientated, seeking opportunities and identifying innovations to fill these opportunities. An entrepreneur has a preference for creative activity, manifested by some innovative combination of resources, for achieving financial, economic, or social wealth. Entrepreneurs are creative in obtaining resources, overcoming obstacles, and implementing ideas. While there is considerable overlap between managers and entrepreneurs, the concepts are not the same; entrepreneurs can be managers and managers can be entrepreneurs by consciously

Table 1.3 The role of the entrepreneurial manager

The Entrepreneur		The Manager
✓ Discover		✓ Forecaster
✓ Visionary		✓ Planner
✓ Innovative		✓ Organizer
✓ Creative		✓ Coordinator
✓ Calculated risk taker	The Entrepreneurial Manager	✓ Communicator
✓ Opportunity seeker		✓ Facilitator
✓ Resource leverage		✓ Motivator
✓ Self-confident		✓ Leader
✓ Drive and intrinsic motivation		✓ Controller

combining the various functions of the key roles at the appropriate times as indicated in Table 1.3.

1.7 Entrepreneurial Process

The entrepreneurial process, however, involves more than just problem solving. All entrepreneurs—private, corporate, and social—must find, evaluate, and develop an opportunity by overcoming the forces that resist the creation of something new Understanding how entrepreneurship works requires recognition of the process involved and how to effectively manage that process. It is a process that can occur in different settings but changes due to the diversity that exists among private, corporate, and social contexts.

The entrepreneurial process has four distinct phases: (1) identification and evaluation of the opportunity, (2) development of the business plan, (3) determination and evaluation of resource requirements, and (4) implementation and management of the resulting enterprise. Although these phases proceed progressively, no one stage is dealt with in isolation or is totally completed before work begins on other phases. For example, to successfully identify and evaluate an opportunity (phase 1), an entrepreneur must already have in mind the type of desired business (phase 4). The main aspects of the entrepreneurial process are presented in Table 1.4 (see Hisrich, 2014).

1.8 Effective Entrepreneurial Management

Effective entrepreneurial management in private sector entrepreneurship, public sector entrepreneurship, corporate entrepreneurship, and social entrepreneurship requires a different mindset and actions than generally occurs. These individuals tend to have the following characteristics: a strong drive and energy; a motivation to change; a desire to achieve; challenge the past way of doing things; focuses on the

Table 1.4 Aspects of the entrepreneurial process

Identify and evaluate the opportunity	Develop the business plan	Resources required	Launch and manage the enterprise
• Opportunity assessment • Creation and length of opportunity • Real and perceived value of opportunity • Risk and returns of opportunity • Opportunity versus personal skills and goals Competitive environment • Creating opportunity assessment plan	Section 1 • Title Page • Table of Contents • Executive Summary Section 2 • Description of Business • Description of Industry • Technology Plan • Marketing Plan • Financial Plan • Production Plan • Organizational Plan • Operational Plan • Summary Section 3 • Appendixes (Exhibits) • Creating a business plan	• Determine resources needed • Determine existing resources • Identify resource gaps and available suppliers • Develop access to needed resource suppliers	• Develop launch plan • Establish culture • Understand key variables for success • Identify problems and potential problems Implement control systems • Develop management style • Develop growth strategy

Source: Authors' own table based on Hisrich (2014)

future and new opportunities; takes risks; is very proactive; and develops a strong team and coalition.

1.9 Summary

This chapter is focused on the foundations of effective entrepreneurial management, the focus of this book. First the aspects and differences of entrepreneurship in the private sector, corporate entrepreneurship, public sector entrepreneurship, and social entrepreneurship are discussed. This is followed by a discussion of the similarities and differences between an entrepreneur and manager. Following a presentation of the entrepreneurial process, the chapter concludes with a discussion of effective entrepreneurial management.

Case Study: Jaconet Brunette Opened a Beauty Salon

Jaconet Brunette opened a beauty salon in Menlyn shopping center in Pretoria. She grew up in an entrepreneurial home and except for a short period in training, had always had her own business. After 3 years of establishing the salon, she had four employees and her turnover had trebled.

(continued)

She opened a second salon after 1 year in Hatfield in Pretoria some 5 km away from the old salon. She appointed her best employee to run the business, hoping to convert it into a franchise eventually. She went to a major exhibition in London and managed to identify a range of products to import exclusively for the franchise system. A few containers were imported and most of the products were sold. It did, however, require additional financing from the bank and time to arrange for clearing of the goods at Customs and Excise in Kempton Park.

The Hatfield branch never seemed to take off and only managed to break even. Jaconet spent a lot of time at the Hatfield branch trying to develop a client base and to control activities. The good employee turned out not to be such a good manager and eventually resigned. Jaconet decided to sell the Hatfield branch after 3 years of establishment as it did not seem to grow at all. She believed that the attention Hatfield required was impacting negatively on her Menlyn salon which, after a few years, had shown a decline in turnover. She downsized this salon from five to four employees and the business is back on track again. When asked about further explanation her comment was: "I don't want the hassle of another branch. I'm quite happy with the pre-sent business. I did not make any more money having two outlets."

Assignment

1. Discuss whether this is a small business or an entrepreneurial venture!
2. Does the desire to grow make a venture more entrepreneurial? Discuss!
3. Discuss the pressure on resources in this case.

Sources: This case is written and adapted by the authors based on the information in Nieman, Nieuwenhuizen, & Hough, 2003.

Questions for Discussion

- Discuss the entrepreneurial activities in several sectors—private, public, government and corporate—by comparing and contrasting the features of each.
- Examine *entrepreneur vs manager* characteristics relating to a business near you, discuss their responsibilities and daily activities.

Click on Web

- https://bitwizards.com/Thought-Leadership/Blog/2011/December-2011/20-Questions-for-an-Entrepreneur
- https://www.entrepreneur.com/article/225519
- http://www.forbes.com/sites/skollworldforum/2013/05/02/the-rise-of-social-entrepreneurship-suggests-a-possible-future-for-global-capitalism/#62f273cee13b

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2 Entrepreneurial Business Planning

Learning Objectives
After reading this chapter, you should be able to:

- Understand the importance of planning in effective management.
- Know the importance and uses of the business plan.
- Understand the contexts of a business plan.
- Be able to prepare a business plan.

Profile: Sophia Amoruso—Nasty Gal

Sophia Amoruso is a perfect example of this generation's entrepreneurial moxie. Fittingly so, the word "moxie" is a dead-on description of Amoruso. Growing up as a rebellious youth, Amoruso spent most of her late teenage years and early 205 darting up and down the west coast, finding work in record stores and fancying such notions as anarchy and revolution. After dropping out of photography school in 2006, Amoruso, confident in her own edgy and vintage fashion tastes, began selling cheaply purchased thrift store finds on her eBay store, Nasty Gal. Her edgy, vintage tastes in clothes soon gained the attention of other young women willing to pay more for ethereal pieces too unique to be found in retail stores. Amoruso's business smarts did not end with her keen eye for clothes. While other eBay sellers commonly posted pictures of their pieces draped over dull, headless mannequins, Amoruso paid local California girls in either cash or hamburgers to model her pieces in front of different backdrops. Her fresh, personally styled eBay photos alone brought in even more visitors. Amoruso soon realized the amount her customers were willing to pay for her items and began marking

(continued)

R.D. Hisrich, V. Ramadani, *Effective Entrepreneurial Management*, Springer Texts in Business and Economics, DOI 10.1007/978-3-319-50467-4_2

up the prices of her finds, gaining margins to the tune of hundreds of dollars per piece. This barely slowed the growing mania of her followers for more, and Nasty Gal soon found itself the leader of a trend-hungry fashion cult.

Leveraging the unique value her own tastes have brought to her business, Amoruso has continued catering to her quickly expanding customer base. Her product lines, no longer dug up from thrift store bins, are now from specially picked, partnering designers. She has since bought the NastyGal.com domain from its previous owner, leased a 500,000 square foot fulfillment center in Kentucky and finally decided to partner with a venture capital firm famous for its investments in now popular fashion sites such as Net-A-Porter and ASOS. The $50 million investment is now helping with expansions such as Nasty Gal's new and extremely successful in-house clothing line.

From its start-up in 2006 to the end of 2012, Nasty Gal has exponentially increased in size—its 2012 sales alone came close to $100 million. Most of its marketing and advertising is done through social media such as Facebook, Twitter, Pinterest and Instagram. Many of Nasty Gal's customers, rather than seeing a commercial on TV, are led to the company's website through word of mouth. And while the company can now afford to move into retail shops and larger advertising ploys, Amoruso has yet to budge in that direction. Her resistance to abandon the original personality of her business has been shown in the company's selective choices for expansion. Until her recent venture capital partnership, Amoruso had yet to take on any type of debt, reinvesting all of her profits back into the company. There was no need to invest in expensive advertising as Amoruso knew her target customers were already propelling the company's fame through social media outlets. Seven years after the start of Nasty Gal, Amoruso remains particular in what she chooses to sell, not letting any article of clothing deviate from her company's edgy charm. There seems to be no need to include other fashion styles—most of Nasty Gal's product lines sell out, sometimes within minutes.

Amoruso is staying true to her herself and loyal to her fan base. And while naysayers and competitors may shrug Nasty Gal off as a fashion movement destined to become the inevitable old hat, its continued sales growth and army of trend-setting devotees say otherwise. For now, Nasty Gal is not going anywhere.

Sources: This profile is written by the authors based on the information in: Nastygal Website (2016) and Steinbeiser, F. (2012)

2.1 Introduction

Effective entrepreneurial management requires each entrepreneur to take the time to plan the future activities of their business. There can be many forms of planning in both the short and long term and provides a road map for implementing the strategy for the success of the venture. Strategy involves developing a plan for creating and operating a new and/or growing enterprise profitably through the obtainment and development of external and internal resources being able to align with the environment.

A key aspect of developing a strategy at each level (the enterprise level, the corporate level, the business level, the functional level, and the sub-functional level) is establishing goals and objectives. Goals need to be challenging and yet obtainable with effort. They need to be measurable so that the results can be evaluated and performance appraised. In order to accomplish the goals established and implement the strategy, a business plan is often created as it is an effective tool for providing the direction to the entrepreneur.

2.2 Writing the Business Plan

Creating and building a successful enterprise requires effective planning (Trusts & Estates, 2013). Although indeed the process of developing the necessary strategies is important, the process and the discipline required in putting this in writing makes the thinking process more effective giving the venture a better opportunity for success. Often something conceptualized in the mind of an entrepreneur does not make sense once it is com-mitted to writing.

A frequently asked question is how long a business plan should be (How many pages should it have?). Although there is no strict answer to this question, sometimes it is too long. The main body of the business plan, which is discussed later in this chapter, usually is about 30–40 pages. This does not include exhibits or appendices which contain additional market statistics, the actual patents, the resumes of the management team and scientists, and other material that can add another 20–100 pages of material. And, a two-page executive summary is needed to use as a door opener if capital needs to be raised (Kwicien, 2012). One factor that impacts the length of the plan is its purpose, which is discussed in the next section.

Even though the entrepreneur needs to write the plan itself, he/she should get help with editing and laying out the plan in the most favorable way. No matter how good the content, the way the business plan looks and is presented affects its evaluation. Any spelling errors, mathematical errors, numbers not making sense, or poor graphics impact the evaluation of the plan to some extent. And, a knowledgeable investor will easily discern whether the plan was written, at least initially, by the entrepreneur or prepared externally by someone else.

2.3 Purpose of the Plan

In providing a road map to achieve the goals of the enterprise, there are five general purpose of uniting a business plan indicated in Table 2.1. By far the most frequent reason for writing a business plan is to obtain financing (Boni, 2012). Most entrepreneurs do not have all the resources (particularly: financial) needed to launch

Table 2.1 Purpose of a business plan

• Obtain Finances • Determine Resources Needed
– Determine Existing Resources – Identify Resource Needs – Determine Suppliers of Needed Resources – Develop Approach to Suppliers of Needed Resources
• Establish Direction for Firm • Evaluate Results of Firms
– Management by Deviation – Reporting Results to Stakeholders
• Obtain a Joint Venture Partner

and develop a venture. Usually some external financing is needed called enterprise capital as is discussed in the Chap. 7 of this book. Each of the sources of enterprise capital discussed in this chapter needs a business plan to make decision to invest. Since in many cases only one or two out of the 100 business plans evaluated will receive an investment. The business plan needs to be very carefully crafted particularly the executive summary which is often the only part that is actually read.

Another purpose of a business plan is to determine all the resources needed to launch and grow the business. A careful review of the current existing resources of the entrepreneur and the enterprise and the resources needed at various stages of development such as financial, human, technological, supply, or distribution helps make sure these resources are available when needed (Cordeiro, 2013). Potential suppliers of the resources should be identified along with a solid approach to each supplier.

The third purpose of a business plan is to provide a direction for the new venture. In the development, launch, and growth of a venture there are many different directions and opportunities available (Enman, 2013). A good business plan allows these to be more easily evaluated and the best direction or opportunity selected.

Being able to evaluate the results of the venture is the fourth purpose of a business plan (Rafael, Lorenzo, & Virginia, 2012). The results compared to the forecast in the business plan points out problems that need attention and focus. Pro forma income statements discussed later in this chapter, present forecasted numbers which eventually become actual numbers once the plan is implemented. There is always a positive or negative deviation between the numbers forecasted and the numbers achieved (Benson, Davidson, Wang, & Worrell, 2011). When this difference is large and negatively affects the venture, corrective action is needed. Because an entrepreneur usually never has enough time or money, by focusing on these deviations attention can be paid to the most critical problems. This is called management by deviation.

The final purpose of a business plan is to obtain a partner or outsourcer (Pollock & Sumner, 2012). A business plan lays out the plan for the business for perspective individual and companies and helps them decide whether to be involved. Whether obtaining a member for the board of advisors, a firm in the distribution channel, a supplier firm, or a firm that could be a joint venture partner, the job is easier when a business plan has been prepared. Most seasoned entrepreneurs and individuals will not consent to be a member of any advisory board of a venture without having evaluated at least a preliminary business plan.

2.4 Benefits of a Business Plan

Since a business plan details the entrepreneur's vision and indicates the implementation strategy and the costs involved, it has several benefits and helps avoid some of the problems identified by successful entrepreneurs.

- Determining the amount and timing of resources needed. The business plan indicates the existing resources of the firm, the resources needed and some potential suppliers of these resources. This allows the entrepreneur to determine how much money is needed at various times to obtain these resources and what approach to develop and use to obtain the money as well as any other resources. The money will be obtained from outside capital providers.
- Establishing the direction of the firm. Since the business plan is a comprehensive document, it fully treats all the major issues facing starting and growing the venture. This enables the entrepreneur to develop strategies and contingency plans to reduce the impact of any problems.
- Guiding and evaluating. By setting goals and milestones for the venture, the business plan lays out the intentions of the entrepreneur as well as his/her values. Accomplishments and results can be measured and any deviations to the plan corrected in a timely manner. These results can be reported to all interested stakeholders and to outside providers of financial resources at least four times a year if not more frequently such as every month in at least the first year. By being put together by the entrepreneur and the management team and being reviewed and revised frequently, the business plan can be used to guide decisions and help avoid conflicts.

2.5 Elements of a Business Plan

Although there are some variations, most business plans have the same elements. These can be grouped into three main general sections (Table 2.2).

2.5.1 Section 1

Section 1 contains the title (cover) page, table of contents, and executive summary. The title (cover) page is an important part of every business plan because it has:

- The company name, address, telephone, fax, e-mail address, and website
- Name and position of each identified member of the management team

Table 2.2 Aspects of a business plan

Section 1:	Title Page Table of Contents Executive Summary	
Section 2:	**1.0 Description of Business** • Description of the Venture • Product(s) and/or Service(s) • Type of Industry • Mission Statement • Business Model **2.0 Description of Industry** • Future Outlook and Trends • Analysis of Competitors • Industry and Market Forecasts **3.0 Technology Plan** • Description of Technology • Technology Comparison • Commercialization Requirements **4.0 Marketing Plan** • Market Segment • Product or Service • Pricing • Distribution • Promotion **5.0 Financial Plan** • Sources and Applications of Funds Statement • Pro Forma Income Statement • Pro Forma Cash Flow Statements • Pro Forma Balance Sheet • Break-even Analysis	**6.0 Production (Outsourcing) Plan** • Manufacturing Process (Amount Subcontracted) • Physical Plant • Machinery and Equipment • Suppliers of Raw Materials • Outsourcing Aspects **7.0 Organizational Plan** • Form of Ownership • Identification of Partners and/or Principal Shareholders • Management-Team Background • Roles and Responsibilities of Members of Organization • Organizational Structure **8.0 Operational Plan** • Description of Company's Operation • Flow of Orders and Goods • Exit Strategy **9.0 Summary**
Section 3:	**Appendices (exhibits)** • Exhibit A—resumes of principals • Exhibit B—market statistics • Exhibit C—market research data • Exhibit D—competitive brochure • Exhibit E—competitive price lists • Exhibit F—leases and contracts • Exhibit G—supplier price lists	

- The purpose of the plan, the amount of money needed, and funding increments
- At the bottom of the title page: "This is confidential business plan number _____." A low number should be placed in the blank space; a tracking system should be established of when and who received this numbered plan for a 30-day, 60-day, and 90-day follow up. This statement of course does not legally bind the reader to confidentiality.

The first page after the title (cover) page is the table of contents. This follows the usual format and lists at least the major subsections in each section and the corresponding page numbers, as well as each figure, table, and exhibit. Preferably each major subsection and smaller subsections can be labeled as 1.0, 1.1, 1.2, 2.0, 2.1, 2.3, and so on. The executive summary precedes the numbering and therefore either has no numbers, smaller letters, or Roman numerals. The tables and figures should have a separate list as should the exhibits (appendices).

The last item in Section 1, following the table of contents, is the all-important two-page executive summary. This is by far the most important document in the business plan because it is the screening section. Many readers, especially potential providers of capital, never read beyond the executive summary. One head of a very successful venture fund, who is now managing his eighth fund, indicated that he receives about 1500 business plans a year, discards 1400 based on the cover page or executive summary, and, of the remaining 100, discards 80 based on an initial 1- to 2-h examination. Of the remaining 20, about 4–6 will receive a term sheet and probably an investment from his fund. The executive summary needs to be really well written to invite further reading of the business plan. Some capital providers only want to initially have a copy of the executive summary. If this passes the first evaluation, then the entire business plan is requested.

The executive summary should have the name of the company and address at the top just as it appears on the title (cover) page. It should begin with defining the nature and size of the problem existing. The more significant the problem the better.

Your proposed solution should follow this problem. Again, this is making available several individuals who have had a background check and are capable and willing to do the task on a fee basis. In this section, all competitive ways to solve the problem should be discussed, showing the uniqueness or the unique selling propositions of your solution. Following the solution is the size of the market, trends for at least 3–5 years, and future growth rate. The market needs to be large enough and accessible to deliver the sales needed for the profits and returns expected by investors.

The entrepreneur and team who will deliver these sales and profits then need to be described. The education, accomplishments, and industry experience of each known member of the top management team needs to be described.

The sales and profits, which should be summarized over a 5-year period in the following format:

	Year 1	Year 2	Year 3	Year 4	Year 5
Total revenue					
Cost of goods sold					
Gross margin					
Operating expenses					
Profit (loss) before taxes					

These numbers are taken directly from the pro forma income statement summary in the financial plan in Section 2. Note the exact calendar year is not used, but rather year 1, 2, 3, 4, and 5, with 1 indicating the first year of company operations after the investment is received.

Table 2.3 Business plan (executive summary)—Himalayan Java Coffee Pvt. Ltd.

BUSINESS DESCRIPTION:
The target franchisee is incorporated as Namche Bazar Coffee Pvt Ltd and operates in the name of "Himalayan Java". Himalayan Java Coffee is the first-of-a-kind specialty coffee shop in Nepal. The coffee chain was first started in 1999 and has only seen growth and progression for last 17 years seeing over $5.5 M in revenue for the fiscal year 2014/15 across 8 branches in Nepal. This coffee chain is the trendsetter in the Nepalese coffee shop market and has been very popular among the tourists who visit Nepal as the first store was opened in Thamel - tourist Mecca of Kathmandu.

CURRENT PRODUCTS/SERVICES:
The following points discusses the various products and services of the coffee chain as a whole and the specific product of the target branch is also discussed.

- The **Coffee Shop** caters the need of the growing coffee drinkers in Nepal. The coffee shop will have a variety of hot and cold coffee as well as tea of the highest quality available for the customers. The coffee beans are all produced organically in Nepal and are ensured highest quality.
- The customer can buy **Coffee Bags** from the store. Again, the coffee is 100% organic and manufactured in Nepal. There are several packs and several roasts available.
- The shop also sells **Souvenirs** for the visitors in various forms like coffee mugs, photo hangers, magnetic photo frames and as such. This is very popular among the tourists and requires an increase in the portfolios of the items that the store currently sells.

PROPOSED EXPANSION:
The sales of souvenirs in this particular branch is significantly higher than other franchisees of this coffee chain. The plan is to get a souvenir manufacturer to produce souvenirs specially for this store and grow both the operation.

COMPETITION:
The Namche Bazar store will compete with the local coffee shops and souvenir shops in the respective markets located in this small town. The brand name of Himalayan Java will be very efficient in selling our products as it's a popular name among tourists coming to Nepal. There are no hybrid coffee shop and souvenir shops around the area and this store will be one of its kind.

PRIMARY TARGET MARKET:
The town of Namche Bazar is visited by tourists trekking in the Khumbu circuit and to the Everest base camp. It's a popular destination to take one-two day rest while visiting this area. Namche Bazar have nice places to stay and some great places to eat, but the eateries are on the expensive side. This Himalayan Java Coffee Shop will be a great destination for tourist to get their morning cup of coffee and the destination to buy souvenirs from the base of the Himalayas.

USE OF FUNDS:
The Company is seeking funds to expand the souvenir shop and thus to contract a souvenir manufacturer and also expand the store area. The next five years projected income statement is as follows:

Namche Bazaar P&L ($000)	2016	2017	2018	2018	2020
Revenue from Coffee Sales	23.00	25.30	27.83	30.61	33.67
Revenue from Souvenir Sales	32.00	38.40	46.08	55.30	66.36
COGS	27.00	29.70	32.67	35.94	39.53
Gross Profit ($)	28.00	34.00	41.24	49.97	60.50
Gross Profit (%)	50.9%	53.4%	55.8%	58.2%	60.5%
Operating Costs					
Sales & marketing	3.00	3.35	4.05	4.28	4.79
G&A	11.50	10.00	11.00	12.10	13.20
Total Operating Costs	14.50	13.35	15.05	16.38	17.99
EBITDA ($)	13.50	20.65	26.19	33.59	42.51
EBITDA (%)	24.5%	32.4%	35.4%	39.1%	42.5%

HEAD OFFICE
Tridevi marg, Thamel
Kathmandu, Nepal
Phone: +977-[0]1- 4422519
http://www.himalayanjava.com/
info@himalayanjava.com

TARGET FRANCHISEE
Namche Bazar Coffee Pvt. Ltd.
Namche Bazar – 1,
Solukhumbu, Nepal

MANAGEMENT
Laxman Panthi – Owner
Ganesh Bhandari – Operations Manager
Ashish Hamal – Store Manager

ADVISORS
Dr. Robert Hisrich – Associate Dean, College of Business – Kent State University
Shaurabh Sharma – Consultant, CBM International

INDUSTRY
Coffee Shop and Souvenir Store

INCEPTION DATE
May 2015

EXISTING FUNDING SOURCES
Laxman Panthi
Everest Bank – Working Capital

PRE-SEED FUNDS RAISED
$200,000

SERIES A FUNDS SOUGHT
$500,000

DISCLAIMER: This does not constitute the sale or the offer of sale of any securities. Any such offer or solicitation will be made only by means of a subscription agreement and other documentation to be entered into between IME and an Investor (the "Fund Documents"), which Fund Documents should be read In their entirety, including the risk factors and potential conflicts of Interest described therein.

Source: Prepared by Laxman Panthi, College of Business Administration, Kent State University, Kent, Ohio, USA, for the purpose of this book. Not official Business Plan (Executive Summary) of Himalayan Java Coffee Pvt. Ltd.

The two-page executive summary closes with a statement of the resources needed, the increments of capital accepted, and contact information. Examples of two-page executive summary are provided in Tables 2.3 and 2.4.

Table 2.4 Business plan (executive summary)—Wisr Inc.

wisr

Executive Summary

The Problem

Universities face increased pressure to demonstrate career and degree outcomes for their constituents but are operating in the **communication technology** dark ages when engaging students and alumni. **Career Services** and **Alumni Relations** rely on self-reporting volunteerism which results in **lost engagement data and gift opportunities**.

Our Solution

Wisr is a SaaS solution that engages untapped alumni by providing a private digital networking space for students and alumni to create and curate their personal board of advisors. Our technology builds the front-end of the funnel for advancement offices, while solving critical communications challenges for disparate university constituents.

- Students and alumni join with LinkedIn creating directory of advisors
- Matching algorithm connects users based on affinity, affiliations, and career track
- Users coordinate advisory sessions with mobile scheduling and automatic phone bridge
- Automated marketing & campaign tools to track and convert inactive alumni

'Land and Expand' modules for different audiences

wisr**CAREER**
Alumni <> Current Students
Match alumni with current students for career coaching, internship, and job placement

wisr**INTELLIGENCE**
Reporting & Analytics
Enables donor capacity scoring and profiling for advancement offices

wisr**ALUM**
Alumni <> Alumni
Enables advisory board functionality for alumni to remain connected and supported to university community

Founded by Industry Veterans

Kate Volzer, CEO

- 5 Years Admissions & Career Services Leadership, overseeing UChicago increased applications by 84% and yield by 34%
- VP Business Dev at DecisionDesk; first 7-figure client contract and partnerships with Salesforce, Oracle, Parchment and Hyland
- Chicago Booth MBA; Economics, Entrepreneurship, Strategic Leadership

John Knific, President/COO

- CEO/Co-Founder at DecisionDesk
- Oversaw growth rates of 100%+; managed 25+ employees; Raised $7m+ capital
- Entrepreneur in Residence at Oberlin College

Kris Ciccarello, CTO

- Former Technical Director at Sanctuary Software Studio; VP of Software Development at Exchange Base; Co-Founder & CTO at BeeGit and NgageContent
- Experience building technology teams and launching B2B SaaS products

Pilot Traction

All pilots asked to make nominal financial commitment in exchange for seat on client advisory board.

THE UNIVERSITY OF CHICAGO
DENISON UNIVERSITY
CASE WESTERN RESERVE UNIVERSITY
CEDARVILLE UNIVERSITY
OBERLIN COLLEGE & CONSERVATORY

Addressable Market

Seed/Beachhead* | Select Campuses: 800, $24m
Series A | Inclusive & Graduate Schools: 4,700, $500m
Series B | 'Learners' & Corporate Education: 10,000+, $1b+

*Based on annual subscription price point of $30k which includes a single Module

Fundraise: $1m Seed Round

- Lead by North Coast Angel Fund - $250,000 initial commitment
- Convertible Debt; $2.5m Cap
- Targeting initial $500,000 close in October 2016
- Angel commitments from industry leaders Jason Palmer (Deputy Director, Bill & Melinda Gates Foundation), Christopher Nyren (Founder, Educated Ventures)

Milestones

- Initial 6 Person 'SWAT' Team + 18 Months Runway
- Successful launch with 5 pilot customers
- Close 25 new customers, $1m annualized run rate by YE 2017
- Validate scale metrics in preparation for Series A

2016 Go-To-Market

- **Launch wisrCAREER at 5 pilot campuses.** Pilots asked for nominal fee for place on advisory board
- **Build inside sales rep (ISR) driven sales.** On target for anticipated 3-4 month sales cycle. Develop pipeline for ~25 customers in 2017
- **Prepare launch of wisrALUM & wisrINTELLIGENCE.** Increase average ARR to $30-50,000

Kate Volzer, CEO; kate@wisr.io | John Knific, President; john@wisr.io | Confidential, Do Not Distribute

Source: WISR Inc. Published with permission!

2.5.2 Section 2

Following the executive summary, which is the end of Section 1 of the business plan, Section 2 starts on a new page with its first part: Description of the Business.

2.5.2.1 Description of the Business

In this section, the nature of the venture is described to provide an understanding on the operation of the venture and its delivering the products/services to solve the problem identified. Information on the products/services should be in enough detail to be easily understood; this will be expanded on in Section 3 if it is a technological product or service that employs a new technology and in the product section of the marketing plan (Section 4). The mission statement of the company should be described as well as the business model—the entire picture of how the company does business—and if this business model significantly differs from the way business is presently being done in the industry.

2.5.2.2 Description of Industry

This section discusses the type and size of the industry, the industry trends for the last 3–5 years, future outlook and growth rate, and a thorough analysis of competition presently fulfilling the same need that the new idea fills. This is a large section with significant use of data from authoritative sources. Sometimes there is so much data that only part of it appears in the body of the plan, and the rest appears in an Appendix (exhibit) in Section 3. Graphs, charts, histograms, and other graphics should be used to thoroughly explain the industry, its growth projection, and the competitors. A graph showing the market growing is important based on the trends of this market to date. The market, the market segment, and target market for the first year will be further discussed in the first section of the marketing plan.

2.5.2.3 Technology Plan

Following the description of the industry is the *Technology Plan*. Some business plans, where there is no significant technological advancement in the product/service being offered, will not have a technology plan. For example, one author founded a rainbow decal and sticker company with no significantly new technology so there was no technology plan in the business plan of the company. Whenever the product or service has a patent, there will always be a technology plan as the patent adds value to the venture. A general rule is if you are having a hard time deciding whether to have a technology plan, then put one in because it is better to have one than not. The technology plan describes the state of the technology presently available and how the new technology revolutionizes the way things are done. The patent or patent filing should be discussed and the document itself put as an Appendix (exhibit) in Section 3.

2.5.2.4 Marketing Plan

The marketing plan, the next section, begins with a discussion of the market segment and target market for the product/service (Lavinsky, 2013). It defines, usually through using one or more segmentation techniques, the most appropriate market and its size. Of the many available segmentation techniques (demographic, geographic, psychological, benefit, volume of use, and controllable market elements), the two most widely used are demographic and geographic because this is the way secondary data is published (Viselgaitė & Vilys, 2011). If the venture is a business to consumer (B2C), the most important market data is the demographics of the selected geographic market. The most widely used demographic variables to determine the size of the market and a typical customer profile are age, income, and gender. For a business to business (B2B) venture, the business market needs to be identified using the country classification system of the country for the industrial (business) customer being targeted. The NAIC code in the United States, the SIC code in Korea, and the SIC code in China each uses a unique numbering system to classify each industry and specific products and services in that country. A sum of all the output of these numbers is the gross national product of the country. This procedure will provide the trends, size, and growth rate of the particular industry market that can be used to develop the typical customer profile.

Following the delineation of the target market, a marketing plan needs to be developed to successfully reach and sell to that target market. The marking plan has four major areas—product or service, price, distribution, and promotion (see Table 2.5). The product/service part describes the characteristics and quality of the offering, the assortment of items to be offered, the guarantee, any servicing provided and the packaging. The latter can be very important in the B2C market because it can be a major area of distinctiveness as well as a sales tool in the distribution center(s) used.

The second variable, price, is closely related to the product/service, particularly the quality level. The price, the worst executed of the marketing areas by entrepreneurs, needs to reflect the competitive prices, the costs, and the degree of

Table 2.5 Elements of the marketing plan

• Product/Services – Quality – Assortment – Guarantee – Servicing (if needed) – Package
• Price – Price/consumer reactions relationships – Price/cost relationships – Price/competitive reactions relationships
• Distribution mix Distribution channels: • Retailers • Wholesalers • Representative Physical Distribution: • Storage • Inventory • Transportation
• Promotion – Advertising – Personal selling – Publicity – Sales promotion – Social media

consumer sensitivity to the price. If a distribution system is used, then there will be a chain of markups on the cost in the final price.

The distribution area has two major aspects: distribution channels and physical distribution. The distribution channels include entities handling the product such as retailers, wholesalers, or representatives. The physical distribution or logistics is becoming an increasingly important area and includes transportation, storage (warehousing), and inventory (Mac Naughton, 2012).

The final area of the marketing plan is the promotion area, which is com-posed of advertising, personal selling, publicity, sales promotion, and social media. The latter three are particularly important for technology entrepreneurs because they can be used to produce multiple exposures cost effectively. Social media, including the website of the new venture, is a particularly useful part of the promotion area. A marketing budget needs to be prepared for the first year indicating where the money will be specifically allocated to promote the company and achieve the initial sales of the first year. This first-year sales figure concludes the marketing part of the business plan and is a good start for the next section—the financial plan.

2.5.2.5 Financial Plan

The financial plan, the next part of Section 2, focuses on a discussion of the created statements indicated in Table 2.6. The financial information contained in the financial plan consists primarily of these 12 financial statements. All but one becomes actual statements after the business is launched. Although these statements have the same content, they are different from the actual ones in that they are forecasted—pro forma—statements which will, upon the end of the time period, become actual statements (Cassar, 2010). The one new statement is the first one—the sources and uses of funds statement—which describes how much money is needed (uses) and where it will come from (sources). The uses part often includes money for renovations, inventory, working capital, and reserve for contingencies. Working capital is the money needed until the venture positively cash flows, the point in time when the revenues from operations exceed the cost of operations. Sources of money will always include the entrepreneur and usually friends and family. The other sources of finance include banks, private investors, venture capitalists, and grants, which are discussed in Chap. 7.

Table 2.6 Financial statements in the business plan

• Sources and Uses of Funds Statement
– Pro forma income statement—5-year summary
– Pro forma income statement—first year by month
– Pro forma income statement—second year by quarter
– Pro forma income statement—third year by quarter
– Pro forma cash flow statement—5-year summary
– Pro forma cash flow statement—first year by month
– Pro forma cash flow statement—second year by quarter
– Pro forma cash flow statement—third year by quarter
– Pro forma balance sheet—year 1
– Pro forma balance sheet—year 2
– Pro forma balance sheet—year 3

2.5.2.6 Production (Outsourcing) Plan

Following the financial plan is the production or outsourcing plan that indicates how the offering will be developed and produced. Some ventures will not have this part in their business plan. Each individual cost needs to be specified to provide an understanding of the actual costs involved in the final offering and how much this can be reduced through economies of scale. Each suppliers or outsourcing firms should be described in detail.

2.5.2.7 Organizational Plan

The organizational plan discusses primarily two aspects of the venture: the form of ownership and lines of authority and responsibility. The selection of the general ownership form is country specific, but needs to take into account several aspects, such as taxation, number and location of investors, liability issues, and number and type of employees' perceived fringe benefits that will be paid.

Generally, the ownership form selected should have the lowest possible tax consequences and minimum liability. In some countries, there are also liability issues with the hiring and firing of employees and with closing the company.

Also, in some countries a foreign (resident) partner may need to have a specific ownership position, which in some cases can be over 50 %. These are the overall organizational structures in the United States:

Individual legal entities:
- Proprietorship
- Partnership

Organization legal entities:
- LLC
- SC
- C-Corporation
- Professional Corporation
- Not-for-Profit Corporation
- Hybrid Corporation

Due to the organization becoming the legal entity in terms of liability, an entrepreneur should not establish his or her company as a proprietorship or partnership. And, due to the tax laws, most entrepreneurial companies in the United States are started as an LLC or SC.

The second aspect—lines of authority—can best be viewed in terms of an organizational chart. Although each functional area needs to be specified with a description of the duties and responsibilities, many of these will not have a specific person mentioned in the initial business plans. Sometimes, chief financial officer or human resource manager will not be hired until years after the start-up. The new venture does need a CEO/president, someone responsible for the operation of the venture.

2.5.2.8 Operational Plan

Following the organizational plan is a short section—the operational plan. This describes in detail how the company will operate, including the flow of goods and orders. An important aspect discussed here is the exit strategy by which investors will get their equity and a return on equity hopefully in a 5–7 year period of time from the initial investment. There are three mechanisms for having the capital to provide this exit and return desired: (1) retained earnings of the venture; (2) selling to another financial or non-financial institution or firm; or (3) going public and being a publicly traded company. The most likely exit avenue is selling to another company and, if this is mentioned, then 3–4 likely exit companies need to be identified and discussed.

2.5.2.9 Summary

Section 2 concludes with a brief summary that completes this section of the business plan.

2.5.3 Section 3

Section 3 contains all the backup material to support areas in Section 2. This includes secondary support data, any research data, contracts or leases, the patent document, and most notably the resumes of the entrepreneur and any known members of the management team. Nothing new should be introduced in this section.

2.6 Summary

Every venture needs a business plan to set the direction for the firm and/or to obtain financial resources. The essential elements of a business plan are contained in three sections, with the main elements being in Section 2. The most important document in the plan is the executive summary as most business plans are not read beyond this point by potential investors.

Each business plan needs to be well written and organized and address as many anticipated questions as possible. It needs to flow smoothly and consistently without errors so that the reader has a clear understanding about the details and future success of the new venture.

Case Study: Translation Services

Mark and Andre went to Kent State University for their undergraduate in translation studies, each majoring in Japanese and Russian translation. They shared some classes together while at college and worked together in the

(continued)

group project of the course “Language Project Management”. While working in the group project, Mark and Andre talked about the business side of translation and how they could start a translation service business in their home. They realized that they shared the same dream of working for themselves and decided to meet and talk about the business. Mark and Andre took up freelance projects based on their expertise subcontracted from the companies while in the last year of their graduation. They finally decided to start a company of their own.

They received help from “LaunchNET” (a center established by the university to help entrepreneurial startups from the college) to prepare a business plan and start their own company. They registered their company upon graduation and started getting work from the contacts they made while freelancing. They did both Russian and Japanese translations based on their expertise and grew to cater all the translations needed in a business and sub-contract other language translation to their friends from college. Mark and Andre felt when discussing 1 day about the general operation of the business, the need to hire in-house employees. They began operating from Andre’s house and now have come to a position where they are established for the retail translation needs of the business particularly helping companies to translate contracts in Russian and Japanese language.

Upon research, Mark saw the business potential in localizing the advertising needs of the business for their branches throughout the world since most of the marketing and advertising work is usually done in US. Mark proposed this to Andre and they want to set an office to Cleveland. They sook advise from a business consultant to make a business plan to raise some money. They are now in a crossroad whether they go with the old business model of small works or they should expand and explore a new possibility. Do they have to move to Cleveland downtown for better business opportunities?

Assignments:

1. Discuss the factors that lead Mark and Andre to form a successful business!
2. Examine the advantages and disadvantages of Mark and Andre moving to a different vertical?
3. Prepare an outline of business plan for Mark & Andre’s translation services for the use of raising funds.

Source: This case is written by Laxman Panthi for purposes of this book

Questions for Discussion

- What makes a perfect business plan?

- What are the things to consider while writing a business plan to raise external capital?
- Prepare a business plan following the pattern in Table 2.2.

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- https://www.entrepreneur.com/article/200730
- http://www.greenindustrypros.com/article/10712488/business-planning-key-elements-landscape-business
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Creativity, Innovation and Entrepreneurial Manager

3

Learning Objectives
After reading this chapter, you should be able to:

- Understand the many aspects of creativity.
- Use many creative problem solving techniques.
- Understand the role of creativity in innovation.
- Understand the process of innovation.
- Know the different types of innovation.
- Understand the principles and benefits of innovation.

Profile: Sam Walton—The Manager

A pioneering businessman who broke convention and showed that large discount stores could thrive in small, rural areas, Samuel Moore Walton was born March 29, 1918 in Kingfisher, Oklahoma. He was the first son of Thomas Walton, a banker, and his wife, Nancy Lee. Early in his life Walton and his family moved to Missouri, where he was raised. An able student and a good athlete, Walton quarterbacked his high school football team and was an Eagle Scout. Upon his graduation from Hickman High School in Columbia, Missouri, in 1936, his classmates named him "most versatile boy." After high school, Walton stayed close to home and enrolled at the University of Missouri in Columbia, where he graduated with a degree in economics in 1940.

Following college, Walton got his first real taste of the retail world when took a job in Des Moines with the J.C. Penney Company, which was still a relatively small retailer. After serving as an Army captain in an intelligence unit during World War II, Walton returned to private life in 1945 and used a

(continued)

R.D. Hisrich, V. Ramadani, *Effective Entrepreneurial Management*, Springer Texts in Business and Economics, DOI 10.1007/978-3-319-50467-4_3

$25,000 loan from his father-in-law to acquire his first store, a Ben Franklin franchise in Newport, Arkansas.

In less than two decades, Walton, working with his younger brother, James, came to own 15 Ben Franklin stores. But frustration over the management of the chain, in particular the decision to ignore Walton's push to expand into rural communities, prompted him to strike out on his own.

In 1962 Walton opened his first Wal-Mart store in Rogers, Arkansas. Success was swift. By 1976 Wal-Mart was a publicly traded company with share value north of $176 million. By the early 1990s, Wal-Mart's stock worth had jumped to $45 billion. In 1991 Wal-Mart surpassed Sears, Roebuck & Company to become the country's largest retailer.

Walton was responsible for a lot of the success. His vision of a discount retail store in rural areas was accompanied by the founder's hard-charging, demanding style. Walton, who often began his work days at 4:30 in the morning, expected results from those beneath him, and wasn't afraid to change course or reshuffle his personnel if he didn't like the numbers that came back to him.

Even in the grips of a recession, Walton's stores proved successful. In 1991, as the country was mired in an economic downturn, Wal-Mart increased sales by more than 40%. But that success also made Wal-Mart a target, especially for small-town merchants and other residents who argued the giant chain was wiping out a community's smaller stores and downtown retail. Walton, however, tried to meet those fears head-on, promising jobs and donations to local charities, which the company often delivered in some fashion.

In 1985 Forbes magazine named Walton the wealthiest man in the United States, a declaration that seemed to irritate the businessman more than anything else. "All that hullabaloo about somebody's net worth is just stupid, and it's made my life a lot more complex and difficult," he said.

Source: This profile is written by the authors based on the information in Biography.com, 2015

3.1 Introduction

Even though creativity and innovation are frequently used interchangeably, there are fundamental distinctions between the two concepts. Creativity is a core building block of innovation. Creativity encompasses the process leading to the generation of new, and sometimes valuable ideas. Without creativity, there would be no innovation, as creativity is the foundation on which innovation emerges, develops and grows. Creativity is about developing ideas, processes, or concepts, while innovation is the practical application of these. Creativity can lead to commercialized innovation, but to be successful, the creativity and innovation must create new value for customers and generate return. Twitter, launched in March 2006, as an online social networking and microblogging service that allows users to send and read tweets. This innovative service has gained popularity in a large market with over 700 million users.

Creativity and innovation are not possible without people who have the required competencies, motivation, and curiosity to discover and invent something novel. It is the creativity in people and their ideas that produce innovations, but the organization must support and nurture this in part for their benefit. 3M allows 15% and Google allows 20% of their employees' time researching selected projects. Dyson and Salesforce.com focus on encouraging and following through on good ideas generated by individuals. The people involved in the creative and innovative process can have significant impact on the organization's innovation performance and its ability to be competitive through innovation. Every organization needs to be creative and innovate if they are to develop and grow. From an organizational perspective, developing creativity in individuals at all levels strengthens the organization's ability to recognize and take advantage of different opportunities. The level of organizational support to facilitate and meet the specific challenges in the market determine their success. In turn, when individuals are creative they feel more self-confident and energized and derive personal satisfaction from being creative and productive.

Creativity is a critical skill for recognizing or creating opportunity in a dynamic environment. Creativity resulting in products, services, and processes is now more important than ever due to globalization and hyper competition. It is just as important in the established enterprise as the public sector organization, and the new venture. A creative business like Virgin Atlantic Airways that is willing to take risks and work on keeping ahead of competition is the key to achieving competitive advantage in a highly dynamic competitive market.

This chapter examines ways organizations can prosper through creativity and innovation. Creativity and innovation are discussed by providing an understanding of the aspects of creativity and its contribution to innovation. The creative process is discussed along with some creative problem solving techniques. This chapter concludes with a discussion on the link between creativity and innovation and a discussion of various aspects and forms of innovation.

3.2 Creativity

Creativity is the core of innovation and is necessary to develop innovative business concepts. It is fundamental for identifying the patterns and trends that define an opportunity. Based on a number of perspectives (psychological, social, individual and organizational), creativity is the application of an individual's ability to identify and develop new ideas, processes, or concepts in a unique, novel way. It is the act of relating previously unrelated things—a deviation from conventional perspectives. Both novelty and usefulness are necessary conditions for an idea to be considered creative. The results need to be useful and have value or meaning. Netflix is a highly creative company that recognized an opportunity and capitalized on the success of the DVD and the booming Internet-streaming service. Netflix has been one of the most successful dot-com ventures. Despite a series of hurdles, it was launched in the United Kingdom and Ireland. As shown by Netflix, creativity requires perseverance, passion, and commitment. This is demonstrated by such leading companies as: 3M, Apple, Amazon, Facebook, Google, Salesforce.com, Samsung, Twitter, and Virgin Atlantic Airways.

There is no one idea of creativity that is appropriate for all activities. Creativity requires both cognitive and no cognitive skills, inquisitiveness, intuition, and determination. Creative solutions can be created or discovered immediately or over long periods of time. Creativity is not just a revolutionary changing product that comes from world-renowned innovators like Alexander Graham Bell, Thomas Edison, Albert Einstein, Sigmund Freud, or more recently James Dyson, Steve Jobs, or Mark Zuckerberg. Instead it is the ability to consistently produce different, new valuable results.

Creativity is a process that can lead to incremental improvements or breakthrough innovations. While breakthrough innovations such as penicillin, the computer, and the automobile are wonderful, most innovations make incremental improvements to existing product lines rather than bringing something radically new to market. Technological innovations such as voice and text messaging and the jet airplane occur more frequently than breakthrough innovations. Incremental innovation is the form of innovation that occurs most frequently and makes minor changes in the product or service. American Express is always looking to extend, modify, and enhance its services. Apple's successful innovations include the iPhone and the iPad. But the core innovation for Apple is the platforms that have facilitated an ecosystem of creativity-from gaming to finance to chip making. Google Inc., formed in 1997, has innovation (and enterprise) at the core of their strategy. Initially providing single language search options, google now offers numerous products and services, as well as a variety of advertising and web applications for all task variations, in many languages. Google had been transformed from a single product into a diversified web power. Facebook is a social networking site that created a breakthrough innovation by creating a new culture that changed the way people communicate. Facebook now has billions of users worldwide. General electric is very innovative in the areas of electronic medical records, innovative new power generation that reduces emissions, and Water Explorer for Google Earth. 3M captures the essence of new innovative ideas and transforms them into ingenious products such as the famous Post-It Notes, 3M stain resistant additives and sealers, 3M Mobile Projector MP225a and 3M Unitek Incognito Lite Appliance system.

Creativity can range from low levels to relatively high levels. Lower level creativity frequently involves incremental modifications and adjustments of an existing idea or a combination of two or more previously unrelated ideas in a novel and useful way. Higher level creativity involves more breakthrough contributions. The different types of creativity include:

- Creativity that develops new ideas, processes, or concepts
- Creativity that modifies existing ideas, processes, or concepts. See these examples:
  - Creates a new, improved version that is more efficient and effective
  - Adds additional features and functions
  - Performs in a different setting
  - Targets a new audience
- Creativity that combines things that were previously unrelated.

3.3 Creative Process

Three key aspects of organizational creativity are (1) knowledge, (2) drive, and (3) ability. Knowledge of the course of action is required for opportunity identification, problem solving, and decision making. Drive refers to the passion, desire, and motivation to do something new and novel with the confidence to proceed as a first mover. Ability refers to the ways in which an individual seeks to identify a solution to a problem by adopting diverse and creative techniques in order to accurately assess and evaluate the situation and identify the best, viable course of action. The five components that are the essential aspects of the creative process: Preparation; Incubation; Illumination; Validation; and Implementation.

Preparation Preparation is the background, experience, and knowledge that an individual brings to the opportunity recognition process. In this preparation stage, the individual attempts to find answers to the question or problem. At this stage, it is important to fully understand the issues involved.

Incubation Incubation is the stage where an individual considers an idea or thinks about a problem. Time and space are reflected in the solution or considerations that may not be immediately forthcoming. This stage is important where extra help may be needed in order to progress forward.

Illumination The illumination stage involves coming up with an outline of an answer to the question or problem. Frequently this answer needs to be further refined and modified.

Validation The individual selects the best choice with a calculated level of risk and uncertainty. The ultimate success of the chosen alternative depends on whether it can be translated into action. This stage often requires further modification and adjustments to fit the organizational culture. This is a particularly challenging stage of the creative process because it requires the individual to objectively reflect on the viability of the idea.

Implementation Implementation involves the use of managerial, administrative, and persuasive abilities to ensure that the selected alternative is carried out effectively. This is the transformation of the creative idea into reality.

Innovation occurs through cycles of divergent creative thinking, which brings about many potential alternatives followed by convergence to a selected solution. Divergence is breaking from the normal and familiar ways of doing things. It is focused on coming up with new ideas and solutions. It expands the number of potential solutions through the process of creativity. It is the most dynamic and social phase and underpins the creative process. Convergence is the achievement of some agreement regarding the benefits of a given idea and the value in pursuing that idea. It removes any nonviable options. It is an assessment in terms of the implementation issues. Unless the convergence stage is well managed, the most viable and innovative ideas may be lost. Creativity depends on a repeated cycle of divergence and convergence to first create a diversity of options and then determine the best ideas to implement. This process takes time and depends on the question or problem facing the organization. The creative process involves both logical and analytical thinking in the preparation, validation, and implementation stages. It calls for imagining, using intuition, conceptualizing, and synthesizing in the incubation and illumination stages.

3.4 Trends

A trend often provides a great opportunity for starting a new venture particularly when the entrepreneur can be at the start of a trend that will last a considerable period of time. Seven trends occurring today include: Wearable trend, Green trend; Payments trend; Maker trend, Mobile trend, Health trend, and the Internet of Things trend. Each is briefly discussed below.

Wearable Trend As the cost and size of microprocessors continues to shrink, the ability of computers to monitor and record activity and display relevant information is now a reality. Over $1.4 billion has been invested in the industry since 2009 with over $500 million in 2014 alone. Broadly speaking, the wearable tech industry includes categories such as augmented reality (Google Glass), body monitoring (Fitbit) and point of view (GoPro). Consumer interest in “Smart Watches” is expected to boost the industry further as new companies form to service the industry with applications and accessories.

Green Trend The green sector continues to provide of wealth of inspiration for entrepreneurs around the world. Although investment activity is down from its peak in the early 2000s, data provided by CBInsights show that investor committed over $2 billion in 2014. In recent years, there has been a shift beyond traditional capital-intensive commodities manufacturing and downstream business models designed to scale quickly with relative capital efficiency. New businesses in this area include energy efficiency and storage, software, e-commerce and electronic components. Also, popular are hybrid energy storage approaches designed to stabilize demand on an energy grid such as what is being implemented in Braderup, Germany where citizens can sell excess electricity during peak demand when prices are higher.

Payments Trend Money, and the way we manage and exchange it, continues to be an industry undergoing a massive transformation. According to data analyzed by CBInsights, from 2009 to 2014, over $5 billion has been invested across 811 deals in the payments industry. This industry includes services for lending money (LendingTree.com) to products that allows anyone to accept credit cards (Square), as well as billing and accounting services. Additionally, the popularity of new forms of currency designed to reduce fraud like Bitcoin and the entire ecosystem around financial fraud detection and mitigation will also be interesting to monitor over the next several years.

Maker Trend In May of 2014, Disney announced that it would buy Maker Studios, a series of YouTube channels dedicated to independent inventors, designers and tinkerers for as much as $1 billion. Maker Studios and other outlets like Etsy are part of the growing DIY ecosystem, which is empowering individuals to become makers instead of just customers. According to *Time Magazine* approximately 135 million U.S. adults are considered makers and the industry is expected to grow to over $8 billion by 2020 fueled in part by interest 3D printing products (Bajarin, 2014).

Mobile Trend The mobile phone continues to revolutionize the way we consumer content, make purchases and interact with each other. Consumers are increasingly short on time so activities once confined to a desktop are now being done on the go with their tablet or phone. The value of venture capital deals for those companies defined as being in the mobile industry exceeded $7.8 billion in 2014, according to data from CBInsights. As venture capitalist Benedict Evans of Andreessen Horowitz remarked in 2014," There is no point in drawing a distinction between the future of technology and the future of mobile. They are the same." (Evans, 2014)

Health Trend Health maintenance and concerns about health care provisions together are one of the biggest trends today that will continue in the next decade as the world population ages. This provides many opportunities for entrepreneurs, including cosmetic procedures, mind expansion such as the "brain gym" of Vibrant Brains, personal health portals, point-of-care testing facilities, fitness centers, fitness toys such as the latest Fit Flops and Wii Fit peripherals, fit food, convenient care clinics, and wellness coaches. Green Mountain Digital is developing a social network platform for nature lovers and was the leading selling app in birds.

The Internet of Things Trend The research firm Gartner estimates that by 2020, more than 26 billion devices will be connected to the Internet (Press Release, 2013).

The potential for nearly everything we interact with to be connected to the Internet has given rise to new products that people never imagined could benefit from having an embedded with a WiFi transmitter. Internet connectivity such as light bulbs and thermostats are part of this new trend of "Smart" devices. This reality caused Google's Eric Schmidt to remark recently that the Internet will soon disappear, meaning that you won't even sense you are interacting with it (de Looper, 2015).

3.5 Methods of Generating Ideas

Even recognizing these trends, coming up with an idea to serve as the basis for a new venture can still pose a problem, particularly since the idea is the basis for the business. The entrepreneur can use several methods to help generate and test new ideas, such as focus groups, brainstorming, brain writing, and problem inventory analysis.

3.5.1 Focus Groups

Focus groups have been used for a variety of purposes since the 1950s. In a focus group, a moderator leads a group of people through an open, in-depth discussion rather than simply asking questions to solicit participant response. For a new product area, the moderator focuses the discussion of the group in either a directive or a nondirective manner. The group of frequently 8 to 14 participants is stimulated by comments from each other in creatively conceptualizing and developing a new product idea to fill a market need. One company interested in the women's slipper market received its new product concept for a "warm and comfortable slipper that fits like an old shoe" from a focus group of 12 women from various socioeconomic backgrounds. The concept was developed into a new women's slipper that was a market success. Even the theme of the advertising message came from comments of the focus group members.

In addition to generating new ideas, the focus group is an excellent, method for initially screening ideas and concepts. With the use of one of several procedures available, the results can be analyzed more quantitatively, making the focus group a useful method for generating new product ideas (Cox et al., 1976; Hisrich and Peters, 1982)

3.5.2 Brainstorming

The brainstorming method stimulates people to be creative by meeting with others and participating in organized group experience. Although most of the ideas generated by the group have no basis for further development, sometimes a good idea emerges. This has a greater frequency of occurrence when the brainstorming effort focuses on a specific product or market area. When using brainstorming, four rules need to be followed:

- No criticism is allowed by anyone in the group—no negative comments.
- Freewheeling is encouraged—the wilder the idea, the better.
- Quantity of ideas is desired—the greater the number of ideas, the greater the likelihood of the emergence of useful ideas.
- Combinations and improvements of ideas are encouraged; ideas of others can be used to produce still another new idea.

The brainstorming session should be fun, with no one dominating or inhibiting the discussion. A large commercial bank successfully used brainstorming to develop a journal that would provide quality information to its industrial clients. The brainstorming among financial executives focused on the characteristics of the market, the information content, the frequency of issue, and the promotional value of the journal for the bank. Once a general format and issue frequency were determined, focus groups of vice presidents of finance of fortune 1000 companies were held in three cities—Boston, Chicago, and Dallas—to discuss the new journal format and its relevancy and value to them. The results of these focus groups served as the basis for a new financial journal that was well received by the market.

3.5.3 Brainwriting

Brainwriting is a form of written brainstorming. It was created by Bernd Rohrbach at the end of 1960s under the name Method 635 and differs from classical brainstorming by giving participants more time to think than in brainstorming sessions, where the ideas are expressed spontaneously. Brainwriting is a silent, written generation of ideas by a group of people. The participants write their ideas on special forms or cards that circulate within the group, which usually consists of six members. Each group member generates and writes down three ideas during a 5-min period. The form is passed on to the adjacent person, who writes down three new ideas, and so on, until each form has passed all participants. A leader monitors the time intervals and can reduce or lengthen the time given to participants according to the needs of the group. Participants can also be spread geographically with the sheets rotated electronically.

3.5.4 Problem Inventory Analysis

Problem Inventory analysis uses individuals in a manner analogous to focus groups to generate new product ideas. However, instead of generating new ideas themselves, consumers are provided with a list of problems in a general product category. They are then asked to identify and discuss products in this category that have the particular problem. This method is often effective since it is easier to relate known products to suggested problems and arrive at a new product idea than to generate an entirely new product idea by itself. Problem inventory analysis can also be used to test a new product idea.

3.5.5 Reverse Brainstorming

Reverse Brainstorming is similar to brainstorming, except that criticism is allowed. In fact, the technique is based on finding fault by asking the question, “In how many ways can this idea fail?” Since the focus is on the negative aspects of a product, service, or idea, care must be taken to maintain the group’s morale. Reverse brainstorming can be effectively used better than other creative techniques to stimulate innovative thinking. The process usually involves the identification of everything wrong with an idea, followed by a discussion of ways to overcome these problems. Reverse brainstorming almost always produces some worthwhile results as it easier for an individual to be critical about an idea than to come up with a new idea.

3.5.6 Gordon Method

The Gordon Method, unlike many other creative problem-solving techniques, begins with group members not knowing the exact nature of the problem. This ensures that the solution is not clouded by preconceived ideas and behavioral patterns. The entrepreneur starts by mentioning a general concept associated with the problem. The group responds by expressing a number of ideas. Then a concept is developed, followed by related concepts, through guidance by the entrepreneur. The actual problem is then revealed, enabling the group to make suggestions for implementation or refinement of the final solution.

3.5.7 Checklist Method

In the checklist method, a new idea is developed through a list of related issues or suggestions. The entrepreneur can use the list of questions or statements to guide the direction of developing entirely new ideas or concentrating on specific “idea” areas. The checklist may take any form and be of any length. One general checklist is as follows:

- Put to other uses? New ways to use as-is? Other uses if modified?
- Adapt? What else is like this? What other ideas does this suggest? Does past offer parallel? What could I copy? Whom could I emulate?
- Modify? New twist? Change meaning, color, motion, odor, form, shape? Other changes?

- Magnify? What to add? More time? Greater frequency? Stronger? Larger? Thicker? Extra value? plus Ingredient? Duplicate? Multiply? Exaggerate?
- Minify? What substitute? Smaller? Condensed? Miniature? Lower? Shorter? Lighter? Omit? Streamline? Split up? Understated?
- Substitute? Who else instead? What else instead? Other ingredient? Other material? Other process? Other power? Other place? Other approach? Other tone of voice?
- Rearrange? Interchange components? Other pattern? Other layout? Other sequence? Transpose cause and effect? Change track? Change schedule?
- Reverse? Transpose positive and negative? How about opposites? Turn it backward? Turn it upside down? Reverse roles? Change shoes? Turn tables? Turn other cheek?
- Combine? How about a blend, an alloy, an assortment, an ensemble? Combine units? Combine purposes? Combine appeals? Combine ideas?

3.5.8 Free Association

One of the simplest yet most effective methods that entrepreneurs can use to generate new ideas is free association. This technique is helpful in developing an entirely new slant to a problem. First, a word or phrase related to the problem is written down, then another and another, with each new word attempting to add something new to the ongoing thought processes, thereby creating a chain of ideas ending with a new product idea emerging.

3.5.9 Forced Relationships

Forced relationships, as the name implies, is the process of forcing relationships among some product combinations. It is a technique that asks questions about objects or ideas in an effort to develop a new idea. The new combination and eventual concept is developed through a five-step process:

1. Isolate the elements of the problem.
2. Find the relationships between these elements.
3. Record the relationships in an orderly form.
4. Analyze the resulting relationships to find ideas or patterns.
5. Develop new ideas from these patterns.

Table 3.1 illustrates the use of this technique with paper and soap.

Table 3.1 Illustration of forced relationship technique

Elements: Paper and Soap		
Forms	Relations/ Combination	Idea/Pattern
Adjective	Papery Soap	Flakes
	Soapy Paper	Wash and dry travel aid
Noun	Paper Soaps	Tough paper impregnated with soap and useable for washing surfaces
Verb-correlates	Soaped papers	Booklet of soap leaves
	Soap "wets" paper	In coating and impregnation process
	Soap "cleans" paper	Suggests wallpaper cleaner

Source: Authors

3.5.10 Collective Notebook Method

In the collective notebook method, a small notebook that easily fits in a pocket—containing a statement of the problem, blank pages, and any pertinent background data—is distributed. Participants consider the problem and its possible solutions, recording ideas at least once, but preferably three times, a day. At the end of a week, a list of the best ideas is developed, along with any suggestions. This technique can also be used with a group of individuals who record their ideas, giving their notebooks to a central coordinator who summarizes all the material and lists the ideas in order of frequency of mention. The summary becomes the topic of a final creative focus group discussion by the group participants.

3.5.11 Attribute Listing

Attribute listing is an idea-finding technique that requires the entrepreneur to list the attributes of an item or problem and then look at each from a variety of viewpoints. Through this process, originally unrelated objects can be brought together to form a new combination and possible new uses that better satisfy a need.

3.5.12 Big-Dream Approach

The big-dream approach to coming up with a new idea requires that the entrepreneur dreams about the problem and its solution—in other words, think big. Every possibility should be recorded and investigated without regard to all the negatives involved or the resources required. Ideas should be conceptualized without any constraints until an idea is developed into workable form.

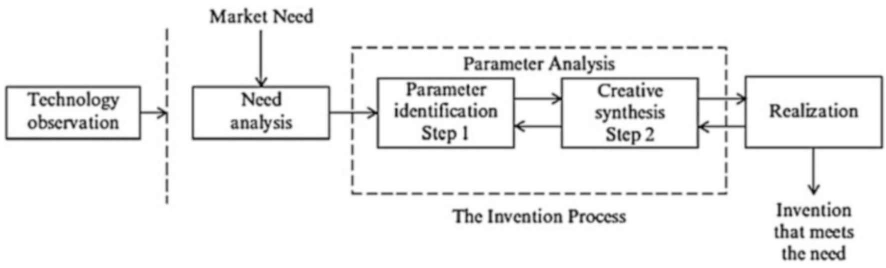

Fig. 3.1 Illustration of parameter analysis. Source: Authors

3.5.13 Parameter Analysis

A final method for developing a new idea—parameter analysis—involves two aspects: parameter identification and creative synthesis. As indicated in Fig. 3.1, step one (parameter identification) involves analyzing variables in the situation to determine their relative purpose. These variables become the focus of the investigation, with other variables being set aside. After the primary issues have been identified, the relationships between parameters that describe the underlying issues are examined. Through an evaluation of the parameters and relationships, one or more solutions are developed; this solution development is called creative synthesis.

3.6 Innovation

Innovation is the key to the economic development of any company, region of a country, or country itself. As technologies change, old products decrease in sales and old technologies dwindle. Inventions and innovations are the building blocks of the future of any economic unit. Thomas Edison reportedly said that innovative genius is 1% inspiration and 99% perspiration.

3.6.1 Types of Innovation

There are various levels of innovation based on the uniqueness of the idea. Figure 3.2 shows three major types of innovation, in decreasing order of uniqueness: breakthrough innovation, technological innovation, and ordinary innovation. These extremely unique innovations often establish the platform on which future innovations in an area are developed. Given that they are often the basis for further innovation in an area, these innovations, when possible, are protected by strong patents, trade secrets, and/or copyrights (see Chap. 6). Breakthrough innovations include such ideas as: penicillin, the steam engine, the computer, the airplane, the automobile, the Internet, and nanotechnology.

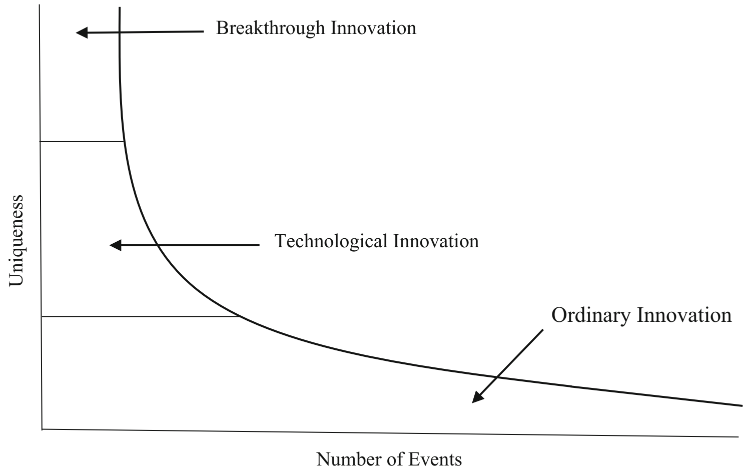

Fig. 3.2 Innovation chart. Source: Authors

The next type of innovation—technological innovation—occurs more frequently than breakthrough innovation and in general is not at the same level of scientific discovery and advancement. Nonetheless, these are very meaningful innovations, as they do offer advancements in the product/market area. As such, they usually need to be protected. Such innovations as the personal computer, the flip watch for containing pictures, voice and text messaging, and the jet airplane are examples of technological innovations.

The company Hour Power Watch was based on a patented process where the watch can flip up revealing a cavity that can be used for pictures, pills, notes, and even nano dispensing and listening devices. Analiza, Inc., a bioscience company, invented, developed, and sells a system that allows drug manufacturers to quickly screen chemical compounds for the ones most suitable for new drugs. This automated discovery workstation simultaneously tests many different drug compounds, identifying the compounds most suitable for a new drug based on how the human body is likely to react to the compound. The company continues to explore other technological innovations such as an advanced blood test product for diagnosing cancer, a product for extending the shelf life of blood platelets, and a pregnancy test for cows.

The final type of innovation—ordinary innovation—is the one that occurs most frequently. These more numerous innovations usually extend an existing innovation into a better product or service or one that has a different-usually better—market appeal. These innovations usually come from market analysis and pull, not technology push. In other words, the market has a stronger effect on the innovation (market pull) than the technology (technology push). One ordinary innovation was developed by Sara Blakely, who wanted to get rid of unsightly panty lines. To do this, she cut off the feet of her control-top panty hose to produce footless panty hose. Investing her total money available ($5000), Sarah Blakely started Spanx, an Atlanta-based company, which in 5 years had annual earnings of $20 million.

Similarly, Martha Aarons, the second flutist of the Cleveland Symphony, practices a 5000-year-old Hindu system of physical and spiritual exercise. One of the exercises—the Downward Facing Dog—requires a "sticky mat" in order to prevent the gloves and slippers from sliding. Not wanting to carry the mat along with her instrument on trips, Martha Aarons invented gloves and slippers with a gripping substance.

3.7 Design Thinking

Design Thinking is a new approach to create breakthrough innovation and promote high-performance collaboration. It is quite different from analytical thinking and is a process for action. It is a method for discovering new opportunities and solving problems. While there are a variety of techniques and tools that can be used, the core process is somewhat universal.

3.7.1 Aspects of Design Thinking

It is generally understood that there are five key elements in design thinking: (1) defining the problem, (2) developing the options, (3) determining the direction, (4) selecting the best solution, and (5) executing. The steps have some degree of similarity to those in the scientific process. Each of these will be discussed in turn.

Defining the Problem This first step, correctly defining the problem, while sounding simple is often the most difficult of design thinking. If the right problem is not defined, then of course the solution, if obtained, is for something else. Defining the problem is usually a team effort with a significant amount of participation by each team member. Defining the problem usually involves observation—discerning what individuals actually do versus what they may say they do. It also involves cross-functional thinking trying to find the real issues involved. Any pre-conceived notions or judgements need to be abandoned so that the right problem can be defined in such a way that creative solutions can occur. If the problem is a sitting apparatus, the problem is not to design a chair but to design something to suspend a person from the floor.

Developing the Options Once the problem is defined, the second element—developing the options—takes place. Care should be taken not to take the same approach as has been used in the past. Design thinking requires the creation of several solutions to the problem for consideration even when one solution seems obvious. For this to occur, multiple reservations and team involvement are important. Multiple people involved develop a far richer range of solutions.

Determining the Direction This third stage-determining the direction-requires that the most promising solutions are carefully nurtured. An environment in the organization needs to be created so that each solution can be allowed to develop and grow. This environment of experimentation and testing allows the best solution to emerge. Often during the stage, ideas are combined to form an even better solution.

Selecting the Best Solution From the many solutions maturing from the previous stage, the best solution can be selected. Prototypes of this solution are created and tested. This vigorous testing helps to ensure that the final solution is the best possible one.

Executing Once the optimal form of the solution to the problem is found, the solution needs to be implemented. This execution element may prove difficult particularly when significant change is involved. Design thinking involves the acceptance of change and risk, which is often not easily embraced both by individuals and organizations. Execution also involves implementing design thinking on a continual basis as it is a repeatable process that will result in creative solutions to problems defined.

3.7.2 Organizational Barriers

Even when the best methodology and techniques are employed, for design thinking to succeed, there is a need for organizational commitment. When first understanding design thinking, an organization should be prepared to fail at the beginning. Most people find it difficult to use their imaginations and react to distractions. In design thinking, failure is not necessarily bad as it can often lead to success. Design thinking focuses on and nurtures a number of alternatives until the best solution emerges. Some common organization issues develop the following barriers to the successful implementation of design thinking.

Lack of Management Commitment This barrier is a significant one that occurs in organizations. Top-level management must openly endorse and practice design thinking. Without this, employees at lower levels of the organization will not embrace and practice it themselves. In many cases, there is resistance at some level in the organization. This permafrost or resistance to using design thinking needs to be unfrozen through training and education. In some cases, the only method of removal is eliminating or reassigning the source of the permafrost.

Lack of Permanent Indicators Another barrier to the successful use of design thinking is due to the lack of measurable indicators of success. The lack of a quantifiable framework to measure the output of design thinking makes it difficult for some organizations to accept and implement it as problem solving methodology.

In some organizations, it is important to begin design thinking by focusing on a small problem with a significant upside potential.

Resistance to Change As with anything new, people and organizations are resistant to change even when they think it is a good thing. This is particularly the case when it causes discomfort and a change in behavior. The more radical the change in behavior that is required in an organization to adopt design thinking, the more the resistance to this change will occur. When this is the case, it is often easier to start the first design thinking process on a problem that is totally outside the usual domain. Once individuals become familiar with the technique, it can then be used to focus on solutions to problems in their usual domain. Three companies will be discussed that have overcome these and other organizational barriers and successfully implemented design thinking: (1) IDEO, (2) Redbox Automated Retail LLC, and (3) IKEA.

3.7.3 Overall Culture

The overall culture of the organization can either support or inhibit design thinking. An organizational culture that is guided by a vision, encourages freedom, and has such characteristics as trust, belief in people, expandability, people growth, and job ownership allows more creativity to occur and increases the quality and output of design thinking versus a more traditional organizational culture. This type of organization provides an environment for employees to want to own their jobs and do everything possible to make the organization and the results of their position world class. A list of the characteristics of this type of organization is found in Table 3.2. The overall cultural climate is one of sharing, trying something new, suggesting and experimenting, and feeling responsible.

Table 3.2 Characteristics of a design-thinking organization

Supports people
Protects people
Tolerates mistakes
Advises people
Takes risks
Shares a vision
Delegates to those closest to the problem
Tolerates internal competition
Stimulates creativity
Actively searches for ideas
Tolerates disorder
Encourages experimentation and tests
Trusts people
Tolerates ambiguity
Does not interfere

3.8 Summary

This chapter focusses on one of the most important yet difficult aspects of effective entrepreneurial management—effectively managing creativity, innovation, and using design thinking which are essential to growing a sustainable venture. Creativity, trends, and several methods of generating new ideas were discussed. The overall concept of innovation was presented in terms of the types of innovation, and the process. The chapter concludes with a discussion of design thinking, a new approach to create breakthrough and other types of innovation and promote high performance collaboration.

Case Study: Shpend Gërguri and Oxford Brookes Bamboo Bikes

Design and research work in the area of push-bike design undertaken in the Faculty of Technology, Design and Environment at Oxford Brookes University has led to the development of a bamboo bicycle frame that capitalizes on the unique damping and strength properties of bamboo.

Eight years ago Dr. Gërguri, a Senior Lecturer in Engineering Design in the MEMS Department at Oxford Brookes University, learnt about the special damping properties of bamboo and other natural fibrous materials. Could this be of some advantage for a bike frame? Also, it had the potential to be a more sustainable option than the majority of bikes that are currently sold and made from steel or aluminum. Climate change, the decreasing supplies of mineral deposits, and the increasing costs and impact of extraction are major factors driving the increasing use of "environmentally friendly" and "sustainable" and rapidly renewable resources. Coupled with this increasing environmental awareness is the growth in the developed world of the fitness, leisure and recreational industries, and more importantly the positive health benefits associated with physical exercise.

The pedal bike has now become the eco-friendly mode of transport of choice, and the sector is seeing unprecedented growth. For example, mountain biking has become one of the fastest growing outdoor activities. In the UK in 2005 there were 1.3 m mountain biking enthusiasts. In 2010 it has been estimated that this figure has increased to at least 2.1 m. Reports continue to report a booming market in the UK. Allegra Strategies, a UK consultancy undertaking the largest UK cycling survey, estimates that the UK cycling market is seeing more than 20% growth per year. The same report predicts that the market is far from saturation and will see significant growth in the next 3 to 5 years. For example, in the last decade London has seen an increase in the number of cycle journeys of 91%.

Bamboo has been used to build bikes before with some notable creative one-offs. Some worthy schemes have also been set up to help locals in deprived regions of the world build affordable transport (see Calfy bikes,

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BamBikes). They can even be bought commercially from the US, although they invariably come with a hefty price tag ($1000's). Dr Gerguri set about exploring the damping properties of bamboo and how to construct a more affordable bamboo bike with the help of a few final year student projects. Initial trials included natural fiber pre-pregs (hemp fibers pre-impregnated with epoxy resin) or simply slotting and bonding bamboo over the original metal joints at the head set, seat mount and bottom bracket. In the latter case, the joints were then over-wrapped with carbon-fiber tows. Although far from sustainable, the bike demonstrated the potential for improved damping and felt as stiff as any normal bike. In 2008, a final year student created a bike frame entirely made from bamboo, utilizing both the bamboo cane and this time bamboo fiber at the joint instead of carbon-fiber.

Dr. Gërguri said 'the bike looked really good and was displayed at Venture Fest and, in particular, Bristol Bike Festival, where it got a considerable amount of attention from keen mountain bikers'. The bike, however, was not stiff enough although further experimental work again demonstrated excellent damping properties. Given the interest at the two events Dr. Gërguri secured some funding from the University to perform a small market research survey on what the public thought about riding and owning a bamboo bike. This provided the confidence that a more sustainable bike was genuinely of interest to cyclists and some more funding was sourced through the University Research and Business Development Office to explore the potential to develop a bamboo mountain bike. At this point, Dr. Broughton, a Reader and specialist in adhesive joining technology residing in the same Department was brought in to help with the design of the joints. Bonding technology played a fundamental role in ensuring the durability and performance of the bonded connections, which from the market research had been highlighted as a potential concern'.

In 2011 a concentrated effort was seen to develop a plausible and manufacturable bamboo bike frame. Six Oxford Brookes MEng students undertook the main design and testing work as part of their group project work, building the two frame prototypes to complete in the Transalps 2011 Competition as part of the field testing.

Dr. Gërguri praised the students, 'they were really enthusiastic and really got involved. Being able to see a concept develop from simple sketches through to a finished prototype is particularly rewarding and a great student experience'. Shortly before the main field test trials the bike was submitted for independent evaluation against the European Safety Standard EN 14766 for mountain bikes. Passing this was a significant milestone and confirmed the frame was fit-for-purpose. The field testing fell nothing short of a grueling traverse of the alps in a competition stage race that covered a distance of 670 km and 21,000 m of climbing over 8 consecutive days of riding (see Craft

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Transalps 2011). The bikes (and riders!) were subject to rain, mud, extreme heat and cold and even snow (one stage had to be diverted as snow blocked the pass). Apart from the diverse weather conditions the bikes were subject to the harsh terrain of the alpine mountain range, which really tested the strength and durability of the bikes.

Summary

Research undertaken in the Faculty of Technology, Design and Environment at Oxford Brookes University into new technologies for enhanced strength and fatigue performance, using a unique design of blended flax and hemp fiber joints, has led to the development of a bamboo bicycle frame that capitalizes on the unique damping and strength properties of bamboo. The results have led to a BS CEN certified Mountain Bike frame which has successfully gone through stringent testing regime at a third party testing center. A patent application was filed for the joining method of the bamboo frame. Bamboo as a natural material has very good damping properties, which means for long bike rides it is an ideal material as it dampens small road vibrations. 2 Bikes also successfully completed the challenging Craft TransAlps 2011 race.

The ultimate aim of the research and design work was to produce a licensable package of IP, which includes the design rights for the BS CEN Certified bamboo bike frames, manufacturing know how (trade secrets), and other 'know-how' which could be supplied as a consultancy support service. In 2011 a license agreement was signed with RAW Bamboo Bikes Ltd to manufacture and sell the bamboo frames. The bike was launched to the Cycle Press and public at Raw's stand at the Cycle Show at the Birmingham NEC from 29th September to 2nd October 2011, where over 300 people got a chance to ride one of the demo bikes around the test track.

Assignment:

1. Discuss and highlight what elements of the research and design work carried out by Dr. Shpend Gerguri and his students constitute to as Intellectual Property rights?
2. Outline and discuss three major creative and innovative steps that were as part of the case study? Discuss their merits and any room for further improvement.

Source: Based on interview with Dr. Shpend Gërguri realized on September 9, 2016; http://mems.brookes.ac.uk/research/sei/bamboobike.

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html; https://worldwide.espacenet.com/publicationdetails/biblio?ii=0&nd=3&adjacent=true&locale=en_ep&ft=d&date=20130207&cc=wo&nr=2013017872a1&kc=a; http://www.bbc.co.uk/news/science-environment-15198952

Questions for Discussion

- Take the following problem statement and brainstorm solutions. Be prepared to present your three most "creative" solutions. Problem statement: "Customers too frequently use an airline and fly to a destination only to find out that their luggage has not arrived."
- Choose a product and use the checklist method to develop new ideas. Be prepared to discuss your product and the three most creative ideas generated.
- Do you think that the Internet can be a source of advantage for one firm over other firms or do you think that it is a necessity just to be able to compete? Be prepared to justify your answer.

Click on Web

- To view the BBC article about bamboo bikes: http://www.bbc.co.uk/news/science-environment-15198952
- https://www.entrepreneur.com/article/250777
- http://www.livescience.com/topics/innovation

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Entrepreneurial Risk Management

4

Learning Objectives
After reading this chapter, you should be able to:

- define risk
- explain clear, speculative and fundamental risks
- define risk management
- know differences between traditional and enterprise risk management
- explain risk management process
- know components of risk
- explain risk treatment options

Profile: Xhemail Dauti—Dauti Komerc

In 1990, as the law for trading companies came into force, which allowed the establishment of private companies, Xhemail Dauti, together with his brothers Hamim, Femi and Besim, after many vicissitudes decided to open his private business in Macedonia. They established 'Dauti–Komerc' and Xhemail left the position of sales director in a state cooperative. Beginnings were not so easy. Various challenges stood in front of them. Although in this initiative were included all brothers, Xhemail was the driving force. Xhemail's enthusiasm, desire and will were very strong to start a private business. At the beginning, Xhemail faced the lack of financial resources. Like many others, he was forced to borrow some money to realize his vision. Then, what was more difficult in the beginning, he couldn't find collaborators who will supply him any kind of goods and by selling them to generate the first revenues. In that time existed an unexplained aversion against private

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companies, as Xhemail says “all private companies were viewed as ‘bandit groups’ from the people and the system of that time”. But, there was no break, there was no going back. Even though he started with a lot of difficulties, as Xhemail established his small business, he did not leave aside the symbols of a serious business. He opened the company’s office, installed telephone (for that time, having a telephone was an ‘impossible mission’), he hired an assistant to coordinate the office issues and hired a personal driver. He often says that in business “no matter how small you are, show yourself as great in front of the others, because in this way you will create a better position in negotiations.”

In 1994, ‘Dauti–Komerc’ was oriented in distributing products for the wide consumption, with special accent on the distribution of food products. In 1997/98, in Macedonia started to penetrate big companies from abroad and there was a dilemma in front of Xhemail—to be merged with these companies or to compete with them in a small market, such as Macedonia. After lots of analysis and discussions with his brothers, he decided to compete with the giants without considering the consequences. The future showed that Xhemail brought the right decision. He managed very successfully to create respectable company’s image and perfect position in the market. The ‘great start’, as he calls it, dates from the 1999, the year when Dauti-Komerc began specialization in the field of import and distribution, where business activities included wholesale, import—export and business contracts with global brands. In the same year, he decided to enter the Kosovo’s market and there, the company was registered as ‘Dauti Komerc—Ferizaj’. In 2001, the business expanded enter another market—‘Dauti-Komerc-Podgorica’ was registered in Montenegro. In 2003 was established ’Dauti Transport—Shped’ with wide range of services in transportation and logistics. In 2005, Xhemail started to produce products with the brand ‘Dauti’, which were very well accepted in the market. The balance ‘high quality—acceptable price’ was the main factor of the success. In the same year, the well-known network ‘Dauti Markets Group’ was founded. For a wider presence in the market, ‘Dauti-Komerc’ established the Cash & Carry sector in 2007. The expansion of the company continued in the following years as well. In 2011, in Albania was launched ‘Dauti Komerc-Durres’. In the same year, this company established ‘Dauti Foundation’, which represents an institutionalization of corporate social responsibility and the philanthropy that this company has shown over the years (this foundation now is known as Albiz Foundation).

Today ‘Dauti Komerc’ operates in four countries with over 800 employees. The company intends to ensure consistency and improvement of business performance and to retain the achieved position in the markets of Macedonia, Kosovo, Montenegro and Albania. Innovations of this company in the logistics spectrum enabled the distribution of new brands with high quality (as Divella, Meggle, Alkaloid, Fruteks, Malizia, etc.).

(continued)

Like any other company, ‘Dauti Komerc’ cannot remain immune against risks. Xhemail says that “as the company was growing, the risks were growing as well, and due to this was shown a need to think about risk management”. To deal with this, ‘Dauti-Komerc’ established a separate sector to be responsible for risk management issues.

This company possesses a large number of cars and transporting vehicles of various types, which are on the move almost every day, and this increase the possibility of traffic accidents. All these are insured in the insurance company ‘Uniqa’. Company’s buildings are insured in the insurance company ‘Winner’. In 2012, ‘Dauti-Komerc’ had a bitter experience, where the entire headquarter and the main storage were swept by fire and this caused major problems to the company. Thanks to the systematic approach of risk management and Xhemail’s sense for management, even in these difficult situations, the company exceeded very fast these problems and was recovered. ‘Dauti-Komerc’ pays about 20,000 € per year for insurance policies.

‘Dauti-Komerc’ has some supermarkets under its umbrella as well, which except 24 h monitoring through sophisticated cameras, they also are secured by physical persons. For this type of protection, the company has signed outsourcing contracts with some security companies, which are responsible for the installation, maintenance and monitoring management systems and physical security of supermarkets. As well, within the company was established a special disciplinary committee to treat thefts and misuses, whether by employees or customers. This committee analyzes these situations in details and then makes decisions how to solve them.

The biggest risk, according to Xhemaili, as he calls it, is ‘the risk of ignorance’, which is related to the human factor, respectively to employees who are not adequate and do not possess the adequate skills to realize certain tasks. Damages from these type of risks are usually large. Therefore, ‘Dauti-Komerc’, especially these last 5 years, invests intensively in human resources. The company provides different scholarships to students and tries to ensure new staff, who would be ready to be faced with the company’s challenges. All potential candidates to be employed in this company, take a psychological test, intelligence tests and tests of practice knowledge. The selected candidates will attend specific training within the company and abroad.

Market risk and competition risk also have special attention in ‘Dauti-Komerc’. Thanks to the permanent pursuing of market movements and the timely response to them, this company remains a leader in many business areas. The company plans to organize for all its employees various training sessions that deal with risk management, where every employee will be a ‘risk manager’ in his workplace.

Source: Based on interview with Xhemali Dauti, realized by the authors on May 30, 2015

4.1 Introduction

This chapter focuses on risks and risk management. As the risk is defined, the chapter continues with discussion of types of risk. Characteristics of risk management is then discussed along with five major risk management phases—context definition, risk identification, risk analysis, risk treatment and risk monitoring and reviewing. The chapter ends with risk evaluation strategies—risk avoidance, risk reduction, risk anticipation, risk transfer and risk acceptance.

4.2 Defining Risk

Richard Cantillon (1680–1734) was among the first economists who identified the connection between entrepreneurship and risk. Entrepreneurs are reconciled with the fact that the risk is their constant follower and their task is to find the best ways for its greater reduction. A sentence says 'nothing is certain, but death and taxes'. Entrepreneurs can expand this sentence and say 'nothing is certain but death, taxes and the risk in their businesses' (Longenecker, Moore, & Petty, 2000). Also Xhemail Dauti testified us this in the introductory profile. Entrepreneurs face different risky situations, such as loss of market share, non-payment of sold goods, decay of products in stores or warehouses, inadequate supply in terms of quality and time, leaving the company by any important employee, theft by customers or employees, fires, earthquakes, floods, traffic accidents and similar. All these pose risk situations that make the venture managing very difficult. The risk cannot be eliminated totally, it can only be minimized. The so-called *residual risk* is always there—the level of risk that remains after the all measures taken to treat it (for example: although the entrepreneur installs anti-theft alarms, however he cannot eliminate totally the risk of theft).

The entrepreneurs before thinking of minimizing the risk in their work, they should define what the risk is and in what forms and types it can occur. Generally, the risk represents a condition or a situation in which someone can or certainly lose something (Vaughan & Vaughan, 2008), or in certain situations, it could be seen as opportunity to gain something. The risk is a situation that would cause smaller profits than expected, or a situation that may result with loss of the company's financial and/or material resources. The risk means facing with market changes, new competitors and technological changes (Carsrud & Brännback, 2007).

Therefore, the risk can be seen as a 'sinking a boat' or 'missing a boat' situation. The first is related to those situations which lead to reduced performance of a company or its failure, while in the second case we are dealing with those actions or situations we have failed to undertake and which would have succeeded (Dickson & Giglierano, 1986).

4.3 Types of Risks

An entrepreneur could be faced with different types of risks. They could be categorized as strategic risks, financial risks, organizational risks, juridical risks, risks of reputation, market risks, security risks, etc.

Some authors (Byrd & Megginson, 2013; Ramadani & Hisrich, 2015) divide risks in pure, speculative and fundamental risks, which characteristics are elaborated as follow:

- *Pure risk*. The risk is considered as pure, when it cause a sure loss, or a situation that it is in break-even point and it is always unpredictable. As examples of this type of risk are counted: fire, death of the owner, loss of any significant customer, traffic accident, theft etc. Many companies own personal transportation vehicles and they face with the traffic accidents risk, some others own buildings that can be touched by the risk of fire, or some others may be exposed towards thefts from outside (customers) and inside (employees).
- *Speculative risk*. When the risk is pure, the entrepreneur faces with those situations in which can only lose, while in a speculative risk, he can lose or can win. An entrepreneur can buy a parcel (land) hoping that its value will increase in the future; another entrepreneur will sell his current business to buy another one with hope that the second one will be more profitable than the first; someone else can buy shares of a certain company and hope for their greater value in the future. As profits can be expected from these investments, there also can occur unpredictable and plot situations, where the new purchased business, land or shares lose their previous value and all this will end up with losses for the entrepreneur.
- *Fundamental (unavoidable) risk*. This type of risk is different from the previous types, because when it occurs, includes all companies which operate in a respective country or community. As possible sources of this type of risk can be the natural forces, political factors, economic factors, social factors, etc. For example, floods, earthquakes, wars, inflation, etc. are fundamental risks.

Table 4.1 shows the results of a research conducted in Macedonia about the types of risks that the entrepreneurs of this country are facing and how do they rank them in terms of their possibility to occur. From here can be seen that Thefts by unknown persons (customers), fire and the possibility of an armed conflict are ranked as the three main risks, while decrease of the value of real estate, floods and earthquakes are ranked as the last against whom their business is exposed.

Besides the aforementioned types of risks, in literature could be found the following as well (Kuratko, 2017):

- *Financial risk*. Due to a certain investment, the entrepreneur puts at risk an important part of its capital, which usually comes from the savings made as a result of any activity in the past. This capital will be lost if the business fails. Besides the invested capital in a business, if the business debts exceed the

Table 4.1 Ranking of risks by entrepreneurs

Types of risks	Ranking	Percentage
Fire	2	14.06
Death of the main person	8	5.73
Bankruptcy of any significant customer	5	10.42
Thefts by unknown persons (customers)	1	19.27
Thefts by employees	6	9.38
Traffic accidents	7	7.81
Decrease of the value of real estate	10	3.13
Floods	11	1.04
Earthquakes	9	4.69
Inflation	4	11.46
Wars (armed conflicts)	3	13.02

Source: Authors' field research

invested capital, the entrepreneur should cover them with his personal wealth—outside the business. In other words, if the company is not able to pay its duties, then the entrepreneur have to sell his own house, car and everything else in order to pay the company's duties. Thus, he is exposed to personal bankruptcy. Many individuals are reluctant to risk personal savings, houses, cars and/or salaries to start their own business—they are risk-averse individuals. Jorge Newbery, founder & CEO of American Homeowner Preservation LLC, by telling his story in *Failure:Lab*, says that he was a millionaire who owned 4000 apartment units. For around 18 months, he lost everything with a debt of 26 million $ that he could not pay. He felt crushed (Newbery 2015).

- *Career risk.* A topic that is often discussed is that how an entrepreneur will be able to find a job or to return to their old jobs, if his business will fail?! How he will tear from himself the epithet of 'a loser'? Taking a decision to start an own business should be thought and analyzed very seriously, especially by those managers who have an secured organizational job, high salary and a good package of benefits. S. MacPherson spent more than 6 months to create a product, which she, personally, wouldn't use very often. She wanted to launch it in a market she wasn't familiar with and to 'unknown' customers. She could not understand why things went wrong and how she produced a product that no one wanted. She convinced herself that could never become an entrepreneur anymore and ended up as a journal's editor (Cooper, 2013).
- *Family and social risk.* Starting an own business, besides the financial/material investment, also requires more energy and time to be spent by the entrepreneurs. Constantly, his business commitments can cause problems of various natures. Those who are married and especially entrepreneurs with children expose their families to the possibility of a permanent emotional scars. Then, the old friends may be lost because of 'not drinking coffee together' for a while. Regarding this, Carl Waldekranz, co-founder of Tictail, an online platform, based in Sweden, that allows small retailers to set up their own websites, will say "One of the crazy

things about being an entrepreneur is that the thing you love the most is also what's driving you crazy sometimes… I never know where I need to be next week, that's exciting, but it takes its toll on relationships with friends and family. However you prioritize, you're letting someone down" (Smale, 2014).

- *Psychic risk.* The greatest risk may be the one that has to do with the psychological wellbeing of entrepreneurs. The financial means can be replaced, the house can be rebuilt, the familiar relations can be improved, the relations with friends can be restored, the children can also be adopted, but some entrepreneurs, who have experienced financial and material disasters, have been unable to return back, at least not immediately. Psychological shock have been so severe that made entrepreneurs unable to deal with any kind of activity. The psychological shock may have been too harsh, that has made entrepreneurs unable to deal with any kind of activity, or some of them, has sent to the death. On January 27, 2013, Jody Sherman, a longtime web entrepreneur and co-founder of the e-commerce site Ecomom (eco-friendly and health products for children) killed himself due to bad results of his business. His body was found in his car on Witch Mountain Road, near Mount Charleston, Nevada, about 25 miles from Las Vegas. Sherman's death was a great shock for the business community. He was 48 years old (Shontell, 2013).

4.4 Risk Management

Risk management represents an integral and very important part of the overall management of the company. Risk management itself includes all activities that are related to the treatment of risks, such as planning, identification, analysis, compilation of proactive and reactive strategies, monitoring and control of risks.

Risk management process is presented in Fig. 4.1. Risk management can be realized at the level of activity (function, project), sector, business or entire company. The last one (entire company) is known as Enterprise risk management (ERM). Today, majority of companies apply traditional risk management (TRM), while ERM remains an aim to be achieved in the future. Differences between TRM and ERM are summarized in Table 4.2, and should be noted that TRM considers risk only as something negative, has a reactive approach and focuses on a certain function, while ERM treats risks as something positive as well, has a proactive approach and focuses on the entire process.

Benefits of risk management can be summarized as follow:

– Treatment of negative situations enables companies to reduce the probability they to be occurred, and if they occur, it will greatly reduce negative consequences. All this allows the company to deal with fewer surprises and less expenses incurred in order to correct the eventual mistakes.
– Risk management enables to accumulate large amounts of data and information from the external and internal environment, which contribute for a better decision-making process in a company.

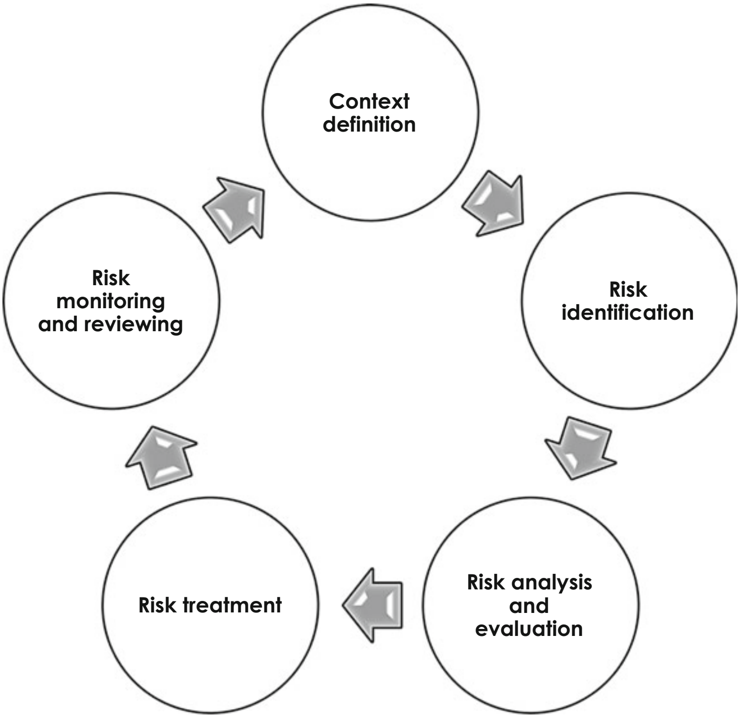

Fig. 4.1 Risk management process (For a complete coverage and discussion of the risk management process, see: NSW Department of Education and Communities (2014), *Enterprise Risk Management in the Department of Education & Communities Guidelines*, NSW, Sydney, p. 8; Vaughan. J.E. and Vaughan, M.T. (2008), *Fundamentals of Risk and Insurance*, 10th ed. John Wiley and Sons, New York, 2008, p. 24; *Handbook of Risk Management Guidelines Companion to AS/NZS 4360:2004*, Standards Australia/Standards New Zeland, Sydney and Wellington, 2007, p. 15; Department of State and Regional Development (2005), *Risk Management Guide for Small Business*, Global Risk Alliance Pty Ltd, Australia, p. 37)

Table 4.2 Differences between risk management types

	Traditional Risk Management	Business Risk Management	Enterprise Risk Management
Focus	Financial and operational risk; internal controls	Business risk and internal control; risk-by-risk approach	Business risk and internal control; entity-level portfolio view of risk
Objective	To protect the value of the company	To protect the value of the company	To protect and to increase the value of company
Scope	Treasure, security and operations are the primary responsible	Business managers accountable	Across the company
Emphasis	Finance and operations	Management	Strategy
Application	Selected risk areas, sectors and processes	Selected risk areas, sectors and processes	All sources of value

Source: Drawn based on Protiviti (2006)

– Risk management contributes to improve the reputation of the company. Stakeholders, as employees, suppliers, bankers, governmental and nongovernmental institutions, other companies, etc., are interested to be part of such a company or cooperate with it.
– Risk management enables the company to better identify and exploit opportunities in the market. A company that creates clearer picture about the inside and outside risks, can easier follow and take advantage of an opportunity and fill the gaps in the market.

4.4.1 Context Definition

Initially, entrepreneurs should define the risk area or category that want to treat further. For example, if the entrepreneur wants to treat the category of risks related to the reputation, he should identify those situations or actions that damage the company's reputation. He can define different categories of risks at the same time that should be treated and with an accurate risk management minimize their impact on the company's goals and performance. An important issue is that the entrepreneur be aware about the risks he may face during his work. This is known as risk's context definition.

Entrepreneurs should establish a systematic approach of managing the risks, particularly pure risks, and always take into account the external and internal environment. The company is not a lonely entity and protected from external environmental impacts. Various financial, political, legal, social or cultural factors influence into the company's activities. Then, the company's mission and goals, internal structure, organizational culture, competitiveness and people, play an important role in its activities as well. All these factors, in one or another way, affect the growth or reduction of the company's risk and in its overall performance.

Entrepreneurs should define the timeframe for finding an adequate solution about the treated risk, the necessary financial resources, the right people and the necessary information. He should define some criteria which clearly define the levels of risk that can be tolerated or not tolerated for a particular company's activity or project (Department of State and Regional Development, 2005, p. 26).

- *Safety*—Safety must be upheld constantly. No injury or fatality is allowable;
- *Financial impact*—Costs for an activity/project must be within the approved budget;
- *Media exposure*—An activity/project should not undermine the reputation of the company and it should be protected from negative media exposure;

- *Timing*—An activity/project must be implemented within a defined timeframe
- *Staff management*—The necessary knowledge, skills and abilities for proper implementation of a certain activity/project must be ensured. If the necessary knowledge, skills and abilities are not available within the company, the outsourcing opportunities should be considered;
- *Environment*—An activity/project should be implemented within the existing environmental legislation and the company should be committed in creating of a clean and healthy environment.

4.4.2 Risk Identification

As the context is defined, the entrepreneurs should precisely identify which risks need to be treated. Risk identification is very important for the company and must be implemented promptly. An unidentified risk at this stage means that this risk will not be treated as well. The risks that are not treated are accompanied by many uncertainties—entrepreneurs do not know what may be their consequences if they occur. In order a risk to be identified properly, the entrepreneur should know the components associated with that risk, such as (Ramadani & Hisrich, 2015):

- *Source*—something that has the potential to change, divert or destroy a certain activity or project or to help that change, deviation or destruction, such as competition or government.
- *Event*—something that happens as a result of the risk's source, such as the expansion of a competitor to the entrepreneur's operating area, or bringing a new law by the government that affects the entrepreneur's business.
- *Consequences*—the result or the impact on the company, stakeholders and assets, such as the loss of market share as a result of competition or the decrease of the profit as a result of a new law that runs tax increases.
- *Reason (what and why)*—why a change, deviation or destruction is occurred, such as the failure to forecast the actions of competition or government decisions.
- *Control and his level of efficiency*—undertaking of activities such as training, market research and market surveillance.
- *When and where*—the time and the place a risk can be occurred.

Entrepreneurs can use two approaches with regards to risk identification, retrospective and prospective approach. *The retrospective approach* is related to the risks that have occurred in the past, is most often used and is easier because approximately are known the reasons and consequences of a similar risk that is identified in the past. As information sources about retrospective risks are: risks' registers from the past, audit reports, customer comments and complaints, previous surveys and interviews with employees and clients and media. *The prospective approach* is associated with risks that the entrepreneurs do not know them, have not occurred in the past, but is expected to occur in the near or far future. This implies to

Table 4.3 Risk registration template

Activity		Compiled by:		Date	
Risk review date:		Reviewed by:		Date:	

Reference	Risk	Source	Reason	Likelihood	Impact	Risk level	Recommended actions	Timeline	Responsible person

register and monitor all major risks. These risks can be identified through brainstorming with employees and other stakeholders, interviews with relevant people and organizations, analysis of the economic, political, legal and socio-cultural environment, surveys with employees and customers about the potential problems in the future, SWOT analysis, etc. Identified risk should be registered. In Table 4.3 is presented a template how to register the risks as a base for their further treatment.

4.4.3 Risk Analysis and Evaluation

During the risk identification phase, the entrepreneur can identify various risks than can have an impact on the activity of the company and prevent the realization of its goals and objectives. However, it should be emphasized that not every risk has the same weight and influence. The entrepreneur must rank risks based on priority in context of ***consequences*** that can be caused if they appear. Based on this, risks can be divided into: *critical* (damages that can cause liquidation of the company), *significant* (damages that require additional investments in order to continue with company's operations) and *irrelevant* (damages can be covered with actual funds). Then, they should define the ***likelihood*** that a certain risk will occur. Accordingly, risk analysis includes definition of consequences that can cause a certain risk and likelihood that this risk will occur. Based on consequences and likelihood can be determined the level of the risk (Fig. 4.2), It can be done by using of the following formula:

$$\text{Risk} = \text{consequences} \times \text{likelihood}$$

Consequences from a specific risk can be characterized as:

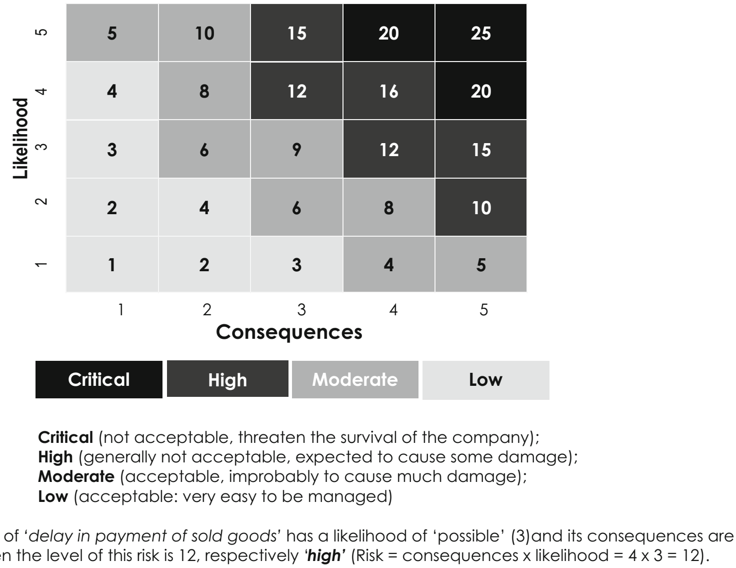

Fig. 4.2 Risk consequence/likelihood matrix

[1]. *Irrelevant*—the risk doesn't impact changes in the company's goals and objectives
[2]. *Minor*—the risk can be treated with existing resources
[3]. *Moderate*—the impact of risk can be treated, but additional resources are required
[4]. *Major*—treatment of the risk will require significant additional resources from other sectors or sources
[5]. *Significant*—the risk might cause the company to fail achieving its goals and in some cases can prove to be fatal to the company

Likelihood a risk to occur can be characterized as:

[5]. *Almost certain*—the risk is expected to occur in the majority of cases, occurs often during the relevant year. Probability of occurrence is 95–100%.
[4]. *Likely*—the risk might occur, at least once during the year. Probability of occurrence is 70–95%.
[3]. *Possible*—the risk might occur at some point, for example, once in 3 years. Probability of occurrence is 30–70%.
[2]. *Unlikely*—the risk might occur at some point, for example, once in 5 years. Probability of occurrence is 5–30%.
[1]. *Rare*—the risk might occur only in extraordinary circumstances. Such a risk has occurred somewhere else and might occur once in every 5+ years. Probability of occurrence is lower than 5%.

The ratio between *consequences* that can be caused by a specific risk and the *likelihood* for that risk to occur is indicated in Fig. 4.2.

Risk analysis and evaluation can be carried out through multidisciplinary groups, hiring a specialist or expert, interviews and surveys, brainstorming, and through statistical analysis, computer simulations and modelling, market research and probability analysis. This phase shows which risks require further treatment and which risks are acceptable and unnecessary to be treated, considering that consequences of these risks are not substantial. An example of risk analysis and evaluation is presented at the end of this chapter.

4.4.4 Risk Treatment Options

During their work entrepreneurs might face different risks, of which some can be avoided and the damages reduced, but there are also particular risks that are unavoidable and the damages that can be caused by them can be fatal to the company. Risk treatment is presented in Fig. 4.3.

Entrepreneurs can use several options to treat risks treatment. The major options are the following:

(a) *Risk avoidance* includes taking proactive measures, such as requiring clients to cover purchased goods with credit through a collateral, or not undertaking any activities at all, which is expected to be damaging;
(b) *Risk reduction* includes taking concrete measures to minimize the consequences of a specific risk, such as installing alarms to secure assets from eventual thefts, or installing fire alarms;
(c) *Risk anticipation*, in literature, also known as the self-insurance strategy, where entrepreneurs leave aside some amount of money in order to cover damages if a risk occur;

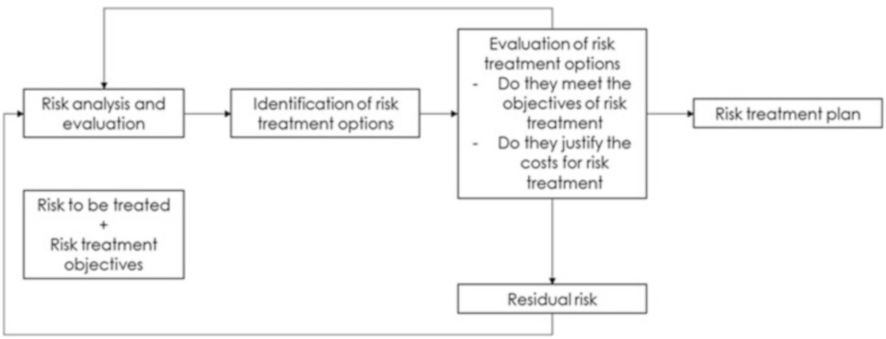

Fig. 4.3 Risk treatment process. Source: Drawn based on information in Boubala (2010, p. 13–16)

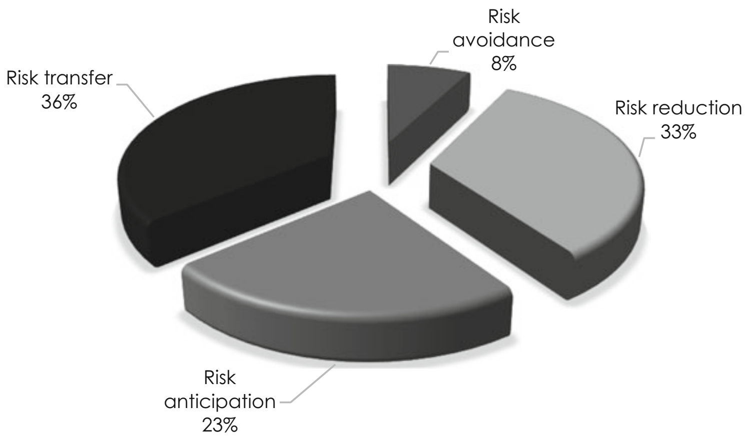

Fig. 4.4 Risk management options chosen by entrepreneurs in Macedonia. Source: Authors' field research

(d) *Risk transfer* means transferring responsibility to a third party, such as insurance companies, for example insuring a factory from fire by transferring risk to an insurance company.
(e) *Risk acceptance* means tolerating risk, in case it is not significantly consequential to the business, or when the treatment is costlier than the damages that would eventually occur, for example, a small flowers' salesman, the value of his products do not exceed 2.500$, cannot afford to install sophisticated alarm systems that cost 4.500$ just to be ensured against thefts.

After the company decides which option they will use, the decision should be backed by concrete measures and activities, for example, if a company chooses the risk transfer strategy, they should ensure their property and buy an insurance policy.

A research conducted in 2010 in Macedonia shows that the entrepreneurs of this country prefer to use more the option of risk transfer (36%) and less the risk avoidance option (8%). The data is shown in Fig. 4.4.

4.4.5 Monitoring and Reviewing

Monitoring and reviewing options and selected plans is very important because the conditions in which a company operates are always changing and a specific option that may have been appropriate for a specific situation, might not be applicable for another.

Experts suggest that every managing process of a specific risk should be *registered* in every detail, because it's possible a respective situation to be repeated, and if so, it could be treated much easier. Also, every type of risk should be communicated among individuals, sectors and managers/owners. *Communication* should be involved in every phase of the risk management process.

Case Study

Divine Flowers—Risk concerns about online buying

'Divine Flowers' is a small company, with five employees, operating in a local mall. As a result of a decrease of consumer frequency in this mall, the owner is thinking of offering his products online. Although this was an early request by many 'Divine Flowers' clients, the owner was concerned whether the customers will accept this system willingly, because of security reasons, legal implications and the exposure to IT risks. Accordingly, the owner decided to compose a risk management plan for this idea.

Risk management plan	Part I—Context Information
Brief description of the activity	Installing an online system for ordering and buying from Divine Flowers for You. It's expected that online ordering and buying contribute with 10–20% in revenue in the first 12 months.
Reasons for this particular activity	A new initiative for business growth and expansion
Goals	1. Installing a secure system of online ordering and buying 2. Minimizing exposure to deceits and other risks to security 3. Maximizing customer trust and readiness for using the online system
The importance of the activity	Medium to high—currently unable to counter consumer demands
Required references (legislative, policies etc.)	1. Country legislation: – Copyright – Privacy – Commercial practices and consumer protection – Spam – Cyber crimes 2. IT security guide
Assumptions	All information is accurate and in real time
Restrictions	1. Budget 2. Available expertise

Risk management plan	Part II—Risk register		
	Risk dimension: security	*Risk dimension: financial*	*Risk dimension: legal*
Serial number	1	2	3
Risk description	Cyber-crimes, including virus damages, identity theft, spyware, general deceits	Expenditures regarding online transactions may exceed the benefits from the new initiative	Legislative breach regarding e-business

(continued)

Impact	Direct financial losses, reputation damages, equipment damages, unavailable system	Direct financial losses as a result of compensation increase, loss of customers as a result of additional spending	Possible fines and legal prosecution
Consequences	Significant	Medium	Medium
Likelihood	Expected	Expected	Possible
Level of risk	Extreme	High	Medium
Risk priority	1	2	3
Treatment options	1. Updating anti-virus software and checking firewall stability 2. Reviewing requirements for online banking security 3. Developing and testing security policies 4. Developing recovery plans in case of a disaster	1. Developing a case study to identify the impact of compensation increase	1. Reviewing every law 2. Consulting with lawyers 3. Developing and testing appeal policies and procedures

Risk management plan	Part III—Risk treatment		
Serial number	1	2	3
Treatment strategy	1. Updating anti-virus software and checking firewall viability 2. Reviewing requirements for online banking security 3. Developing and testing security policies 4. Developing recovery plans in case of a disaster	1. Developing a case study to identify the impact of fee increase	1. Reviewing every law 2. Consulting with lawyers 3. Developing and testing appeal policies and procedures
Required resources	Security guidelines: 5 days available for completion	3 days available for completion	5 days available for completion
Priority	1	2	3
Person liable	Owner	Owner	Owner

(continued)

Deadline	Data X	Data X	Data X
Review strategy	Testing security policies Hire a IT security specialist	Survey customers Review the impact on revenue every week for 3 months	Consult with a lawyer for reviewing policies and procedures Review the legislation every 3 months
RMP developed by	Owner		
Methodology	Brainstorming with staff	Discussions with software developers	Consulting with experienced users
Tools for risk analysis	Developing a risk matrix		
Signature			

Assignment:

1. Discuss about risk management with a local entrepreneur! What are his thoughts regarding these issues!
2. Compile a similar plan as above for an existing company in your community!

Source: This case is written an adapted from the authors based on the information in Department of State and Regional Development (2005, pp. 57–58)

Questions for Discussion

- Define risk!
- Explain pure, speculative and fundamental risks!
- Define risk management!
- What are the differences between traditional and enterprise risk management?
- Which are the phases of the risk management process!
- Elaborate briefly the phases of the risk management process!
- Explain the risk components!
- Explain the options for risk treatment!

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- http://www.dico.com/Design/Publications/En/ERM%202011/ERM_Application_Guide_September_2011.pdf

- https://www.jnj.com/sites/default/files/pdf/JnJ_RiskMgmt_ERMFramework_guide_v16a.pdf
- http://www.lse.ac.uk/accounting/CARR/pdf/dps/disspaper35.pdf
- http://www.ucop.edu/enterprise-risk-management/_files/protiviti_faqguide.pdf

Risk Analysis and Evaluation Example

LIKELIHOOD						Level of risk				
	Almost certain	Expected	Possible	Unexpected	Rare					
Risk	**Commer.**	**Financial**	**Protection**	**Security**	**Legal**					
CONSEQUENCES										
Significant	Significant loss in market share and a loss of 10-30% of clients and no new clients in the past 3 months	A fall of > 30% in revenue	Mistreatments that result in financial losses. Threats to the staff and serious injuries that require hospitalization. Serious damages to the public image.	Death or multiple injuries that require hospitalization.	Investigations from authorities and very high sanctions. Multiple and serious litigations. Company closure.	Critical	Critical	Critical	High	High
Major	Major loss of market share and a loss of <10% of clients and no new clients in the past 1-3 months	A fall of 20-30% in revenue	Mistreatments that result in financial losses. Threats to the staff and serious injuries that require hospitalization. Major damages to the public image.	Major injuries that require hospitalization.	Major legal breaches with high potential sanctions and investigations from authorities. Multiple litigations. The future of the company at risk.	Critical	Critical	High	High	Moderate
Medium	A loss of market share. Existing clients are retained and no new clients in the past 1-3 months	A fall of 10-20% in revenue	Threats to the staff and small injuries that do not require hospitalization. Minor damages to the public image.	Minor injuries – requires first aid.	Major legal breaches with medium potential sanctions.	High	High	Moderate	Moderate	Low
Minor	A minor loss of market share. Existing clients are retained and a fall in new clients (50% from the average)	A fall of < 10% in revenue	Threats to the staff but no injuries. No damages to the public image.	No injuries	Minor legal breaches. Sanctions and investigations are unusual.	High	Moderate	Moderate	Low	Low

Source: Based on Department of State and Regional Development (2005, p. 54)

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5 Entrepreneurial Marketing Mix

Learning Objectives
After reading this chapter, you should be able to:

- Define marketing and entrepreneurial marketing
- Know the main marketing tools
- Apply the pricing methods and strategies
- Compare traditional and entrepreneurial marketing
- Understand the main entrepreneurial marketing forms

Profile: Jay Conrad Levinson—Guerilla Marketing
Jay Conrad Levinson, the father of 'Guerrilla marketing', was born in Detroit, US, on February 10, 1933. He graduated from the University of Colorado in Psychology. His knowledge about psychology enabled him to work with famous advertising agencies, including Leo Burnett in London, UK, where he served as Creative Director, and J. Walter Thompson (JWT) as a Senior Vice President. He was the Chairman of Guerrilla Marketing International, a marketing partner of Adobe and Apple. The most famous marketing campaigns developed by Levinson include The Marlboro Man, Allstate's good hands, The Pillsbury Doughboy, United's friendly skies, Morris the Cat, the Sears Diehard battery, Tony the Tiger, and the Jolly Green Giant.

Jay Conrad Levinson coined the term 'guerilla marketing', describing it as 'unconventional' marketing tools used in cases when financial or other resources are limited or non-existent. As he once said: "I'm referring to the soul and essence of guerrilla marketing which remain as always—achieving conventional goals, such as profits and joy, with unconventional methods, such as investing energy instead of money". Levinson published his famous

(continued)

R.D. Hisrich, V. Ramadani, *Effective Entrepreneurial Management*, Springer Texts in Business and Economics, DOI 10.1007/978-3-319-50467-4_5

book with the same name in 1984. The book "Guerilla Marketing was published by Houghton Mifflin. This book, in 2011, was named by Time as one of the top 25 best business management books. It was sold in more than 21 million copies, published in 58 volumes and was translated in 62 languages. It became a 'must read' for all entrepreneurs, marketers and students.

Levinson taught guerilla marketing for ten years at the University of California, Berkeley Extension Division. In one of his lecture around the world, he would say: "I tell my clients that the single most important word for them to remember while they are engaged in marketing is commitment. It means that they are taking the marketing job seriously. They're not playing around, not expecting miracles. They have scant funds to test their marketing—they must act. Without commitment, marketing becomes practically impotent", while in one other occasion he will continue: "Guerilla takes a while to work—it doesn't happen instantly. In most cases it's going to take about a year to work. Patience is a virtue once an idea has been developed into a fully-fledged campaign, he says, but hesitation is a business killer, particularly when it comes to making the most of the social media as a guerilla marketing tool. You have to get into the fray right now."

Beside his above mentioned masterpiece, among his famous books are the following: *"Guerrilla Marketing Excellence: The 50 Golden Rules for Small Business Success"*. (Mariner Books, 1993); *"The guerrilla marketing handbook"* (Mariner Books, 1994); *"Guerrilla marketing: Secrets for making big profits from your small business"* (Houghton Mifflin Harcourt, 1998); "*Guerrilla Social Media Marketing: 100+ Weapons to Grow Your Online Influence, Attract Customers, and Drive Profits"* (Entrepreneur Press, 2010); *"Guerrilla Marketing for Job Hunters 3.0"* (Wiley, 2011). The list of all his books can be found here: http://www.goodreads.com/author/ list/18089. Jay_Conrad_Levinson. Some of his amazing lectures on guerilla marketing can be found in YouTube. Guerilla marketing's father died in October 10, 2013.

Source: This profile is written from the authors based on information in: https://www.goodreads.com/work/quotes/111216-guerrilla-marketing-easy-and-inexpensive-strategies-for-making-big-prof; http://www.theaustralian.com.au/business/media/guerilla-marketing-guru-helps-level-the-field/story-e6frg996-1225914486276

5.1 Introduction

Entrepreneurial marketing activities are essential for every new or established business. This chapter focuses on the marketing tools, such as product, price, place (distribution) and promotion. Then, the differences and similarities of traditional and entrepreneurial marketing elements and contents are discussed. The chapter concludes with a discussion of basic forms of entrepreneurial marketing such as guerrilla, ambush, buzz and viral marketing.

5.2 Nature of Marketing

Even if marketing today is present in every economic or social activity and entity (company, education, tourism, sport, arts, health, government, political parties, NGOs, etc.), however in attempting to describe and clarify it, in daily life, we come across many misunderstandings and misinterpretations of it. If we would ask different people—what is marketing—we would receive various and different answers. Some would say that marketing is advertising; some others would say that it is a selling; and the third ones will say that it is a trading. It should necessarily be emphasized that advertising, selling or trading do not reflect the whole concept of marketing, because all these represent only 'ingredients' of marketing. Consequently, marketing is a much broader concept than advertising, selling or trading.

Kotler and Armstrong (2015, p. 29) define marketing as "social and managerial process by which individuals and organizations obtain what they need and want through creating and exchanging value with others". American Marketing Association (2013) defines marketing as "activity, set of institutions, and processes for creating, communicating, delivering, and exchanging offerings that have value for customers, clients, partners, and society at large." Hisrich (2000, p. 3) defines marketing as "process by which the decisions are made in a totally interrelated changing business environment on all the activities that facilitate exchange in order that the targeted group of customers is satisfied and the defined objectives are accomplished". Generally saying, marketing is a connecting bridge between the producers and the market (Veseli, Ramadani, & Rexhepi, 2010). Whereas, Ries and Trout (2006) define marketing as a war, where two or more competitors 'fight' to control customers and unlike military wars, this war never ends. Similar explanation was given by J.C. Levinson, our opening profile, where he says: "Marketing is not an event, but a process. It has a beginning, a middle, but never an end, for it is a process. You improve it, perfect it, change it, even pause it. But you never stop it completely".[1] Therefore, *marketing* is a process that through market research identifies the customers' needs, desires and demands and by offering (producing

[1]J.C. Levinson's great quotes can be found here: http://www.azquotes.com/author/38572-Jay_Conrad_Levinson

or servicing), distributing and promoting products/services simultaneously satisfies them and brings profits to the company.

Based on these definitions, marketing embraces several activities that at the same time represent its basic concepts (*see:* Hisrich, 2000; Kerin, Hartley, & Rudelius, 2015; Kotler & Keller, 2012), such as:

Needs, Desires and Demands of Customers The primary task of marketing is to identify what the customers need. On a daily basis, the terms need, desire and demand are often used incorrectly or interchangeably. A *need* is something basic, elementary that a man requires in order to survive. A man needs food, water, air, clothing and shelter to survive, as he also needs to rest, educate and entertain. A need becomes *a desire* when it will be connected to a specific product or service, for example, when a man needs food and he does not require any food, but requires hamburger, pizza or spaghetti. Whereas, *a demand* is related to a specific want and the ability to pay for it, for example, many people may want to have a luxury yacht or private jet, but very few have the ability to buy it. Consequently, if the one does not have the ability to pay in order to satisfy a need or a desire, then we cannot say that we are talking about a demand.

Products and Services After identifying customers' needs, desires and demands, a company must decide what to produce/serve in order to meet them. There should be produced what customers want and not what companies want. As long as the products offered in the market do not satisfy any customers' need or desire, it is very hard to say that the company implements the concept of marketing.

Information Customers should be informed about the product (s)/service(s) that are offered in the market. As the company informs customers about its offering, it should make efforts to convince them to buy/consume the offered product(s)/service(s) in the market.

Exchange At the moment when a product is produced and the customer is informed about it, the company must identify the best way the product reaches the customers. A manufacturer may do so either through direct contact with the customer, or through wholesalers and retailers. Equivalently, for the offered products the manufacturer/wholesaler/retailer receives money from the customer. With regards to exchange, should be considered the following conditions: (1) there should be at least two parties, (2) each party must possess something that has value to the other party, (3) each party must be able to communicate and offer something, (4) each party must be free in deciding to accept or reject the offer, (5) each party must believe that it is a good, reasonable and profitable agreement with the other party (Kotler & Keller, 2007, p. 5).

Market A market is a place where the exchange of products/services happens. In the traditional sense, the market is the place where the buyer and seller meet. Today, with the development of Internet, in addition to the market as a physical location, we have the digital market, where there is no physical location where the buyer and seller meet, but sales transactions are conducted via the Internet (see chapter on electronic commerce). A company cannot cover the whole market, or satisfy the needs and desires of all customers. But, it will be focused on a group of customers who can be differentiate by age, gender, education, income, religion, life style, etc. This process is known as market segmentation.

Marketers Marketers are those, who should identify the customers' needs and desires, provide products and services in the market, inform customers about products/services offered, choose in which market to offer these products/services and seek answers about the market's reaction with regards to the products/services offered in the market.

Competition Competition includes rival companies that offer or can offer the same, similar or substitute products and services of the respective company.

Environment The environment includes all the factors, external and internal, which directly and indirectly influence the activity of the company. Environment could be macro and micro. Macro-environment includes natural, demographic, economic, political, technological, legal and socio-cultural factors, while the micro-environment includes the company, suppliers, intermediaries, customers, competition and public.

5.3 Marketing's Tools/Instruments

Marketing is constituted of four main tools or instruments, who are presented by the acronym 4P (*p*roduct, *p*rice, *p*lace and *p*romotion). Today there are tendencies that acronym 4P becomes 7P, where to 4P's are added elements such as: *p*eople, *p*rocess and *p*hysical evidence (usually in the service industry). 4Ps are viewed as instruments of manufacturers/wholesalers/retailers, which use them to influence the purchase of products/services by customers. According to Lauterborn (1990), to manufacturers/wholesalers/retailers' 4Ps correspond the customers' 4Cs (customer solution, customer cost, convenience and communication). While, according to Thisa Yakorn (2010), today we can discuss as well as for 4Vs of marketing, such as: *v*alidity, *v*alue, *v*enue and *v*ogue (Table 5.1).

5.3.1 Product

Product represents the first element of the marketing-mix. A ***product*** can be counted everything that is offered in the market in order to satisfy customers' needs, desires and demands. In marketing, product is more than something you can see and touch. For marketers, product provides a set of attributes of tangible and

Table 5.1 Marketing's tools/instruments

4P	4C	4V
Product	Customer solution	Validity
Price	Customer costs	Value
Place	Convenience	Venue
Promotion	Communication	Vogue

Table 5.2 The link between features and benefits of products and services

Product/service's features	Product/service's benefits
1. 2. 3. 4. 5.	1. 2. 3. 4. 5.
Declaration of benefits:	

intangible assets, such as: packaging, color, quality, brand, design, warranty, etc. Many entrepreneurs use Table 5.2 in order to create a clearer picture regarding their product(s)/service(s) in terms of their features and benefits that each feature brings to customers (Table 5.2).

In order to be attractive for customers, investors and creditors, a certain product should possess these characteristics: should be sold fast and easy; should have an acceptable price for the manufacturer and the customer; should have high quality; should be competitive in the market; and should be patented.

Several accompanying issues and activities are related to the products that enable them to appear as more completed, more attractive and fulfill customers' needs and desires to a greater extent. Among them, as more important are product-mix, brand, packaging and labelling.

Product-mix includes the total number of products/services that a company offers in the market. Product mix has four dimensions: width, length, depth and consistency. Width of the product-mix represents the number of product's types offered by the company. Depth of the product-mix is related to the number of product's variations within a type, in terms of color, taste, size etc. Length of the product-mix has to do with the number of variants of all products offered by the company. Consistency of the product-mix shows the relationship of products/services in terms of consumption, production processes, distribution channels and promotional programs.

Brand is a name, symbol, design or a combination of all three, through which a product or service is identified and distinguished from competition's products and services (McDonald's, Pizza Hut, Mercedes, Opel, IBM, Nike, etc.). Brand has its name and trademark.

Packaging is concerned with the design and manufacture of product's wrappers, which protects the product from any possible damage and makes it more attractive to customers.

Labelling is closely linked with the packaging, which aims to inform customers about name of the manufacturer, content of the product, date of production and expiration, use and level of product quality (product type A, B or C).

5.3.2 Price

Price of products/services represents a very important and sensitive marketing-mix element. ***Price*** represents the amount of money, goods or services that have to be provided in exchange for the possession or the usage of a product/service. Companies must be careful when they set the price of products/services. If marketers will opt for a cheap price, the customer may arouse suspicion that they are low-quality products. On the other hand, if you opt for very high prices, customers may resist the consumption of those products. Therefore, marketers are obliged to identify and set a price that meets the requirements of the company for profit realization (and maximization), and meets the customers' expectations and material/financial conditions. Therefore, a price should be acceptable to both sides, for the manufacturer/wholesaler/retailer and the customer. Marketers can use several methods to set the products/services' price. Some of them are described below.

Methods Based on Costs Based on these methods the company should calculate the necessary costs for manufacturing a product and then add a percentage or amount of money that represents the profit of the company. Thus, a price determined by these methods must cover total costs and provide profit for the company. In order to apply these methods, a marketer should have information about *fixed costs* (they remain unchanged, regardless of the volume of production), *variable costs* (they change according to the increase or decrease of production's volume) and *total costs* (the amount of fixed and variable costs). These methods are discussed below.

(a) Markup In determining the selling price, marketers use a certain percentage, called markup. Markup is added to costs or selling price of the product (Fig. 5.1). Marketers have two ways to set the markup, using:

- *Costs*. For example, if the costs of producing a product have a value of 82€ and the same is sold for 124€, then the markup will be:

$$\text{Markup} = \frac{\text{margin value}}{\text{costs per unit}} = \frac{124€ - 82€}{82€} = 0.5122 \text{ or } 51.22\%$$

- *Selling price*. For example, if the product is purchased for 124€ (selling price) and sold for 157€, then the markup will be:

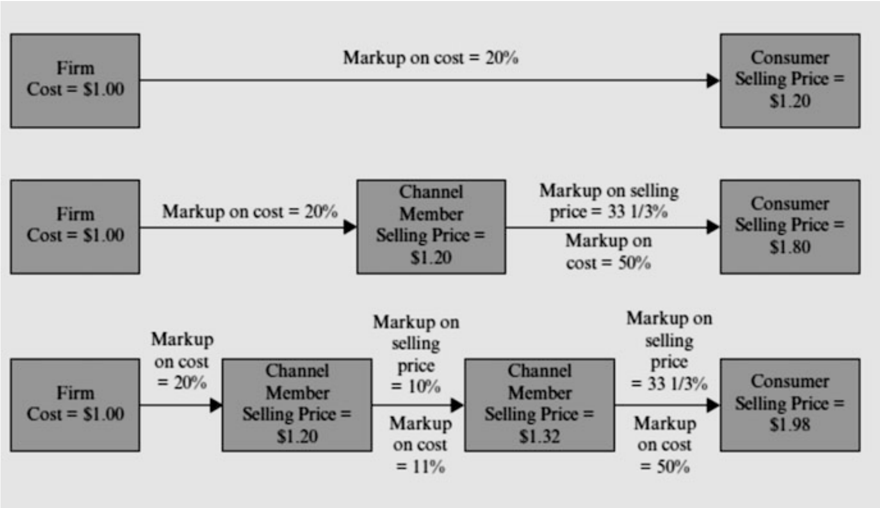

Fig. 5.1 Markup method illustration. **Source:** According to Hisrich (2014, p. 168)

$$\text{Markup} = \frac{\text{margin value}}{\text{Selling price}} = \frac{157€ - 124€}{124€} = 0.2102 \text{ or } 21.02\%$$

Example

An entrepreneur wants to produce and sell 80,000 units of a product (Q). Variable costs per unit (VC) are 12 €, while fixed costs (FC) are 400,000 €. Costs per unit can be calculated by this formula:

$$\text{Costs per unit} = \text{VC} + \frac{\text{FC}}{\text{Q}} = 12€ + \frac{400,000€}{80,000} = 17€$$

If the entrepreneur wants to set markup of 30%, then the selling price will be:

$$\text{Price} = \frac{\text{costs per unit}}{1 - \text{markup}} = \frac{17€}{1 - 0.30} = 24€$$

In this case, the entrepreneur will earn 7 € (24 – 17=7) for each product unit sold. If the next seller (wholesaler) wants to set a margin of 50% of this product, then the price, according to this method will rise to 48 €.

Beside in percentage, markup can be set as an amount of money (in \$, €, £, ¥, etc.), where this amount will be added to the costs made for that product, for example, someone buys a product for 90 € and adds 40 € as a markup, then the selling price of that product will be 130 €.

(b) Break-Even Point Method Break-even point represents the point where the total revenues from a particular product are equal to the total costs made for its production. In other words, this is a situation where the company does not realize neither a loss nor a profit from production and sale of a particular product.Break-even point (BEP) is calculated by the following formula:

$$\mathrm{BEP} = \frac{\text{fixed cost (FC)}}{\text{Price (P)} - \text{variable costs per unit (AVC)}}$$

The price that shows that the company is at its break-even point can calculated by the following formula:

$$\mathrm{P} = \frac{\text{profit (p)} + (\text{variable costs per unit (AVC) x quantity (Q)}) + \text{fixed costs (FC)}}{\text{quantity (Q)}}$$

Example
If, for the production of 10,250 units of a product, the fixed costs are 117,000 €, variable costs per unit are 24.6 €, the lowest selling price of that product (break-even point) should be:

$$\text{BEP price} = \frac{0 + (24.6€ \text{ x } 10,250) + 117,000€}{10,250} = 36€$$

In this case, the company, with a price of 36 €, does not realize neither a profit nor a loss. However, each company exists in order to realize a profit from its activity. If we assume that the company tries to obtain a profit of 12,000 €, then it should determine its product's selling price as below:

$$\mathrm{P} = \frac{\mathrm{p} + (\mathrm{AVC} \text{ x } \mathrm{Q}) + \mathrm{FC}}{\mathrm{Q}}$$

$$\text{Price} = \frac{12,000€ + (24.6€ \text{ x } 10,250) + 117.000€}{10,250} = 37.2€$$

Thus, if the company sells its products at the price of 37.2 €, it will earn profit of 12,000 €.

Pricing Based on Competition A company can set the prices of its products and services by following the prices of competitors. It can set the prices of its products and services under, in the same or above the level of competition prices. Companies can attract customers by offering lower prices than the competition, or keeping the same prices, when competition increases them. The company can set even higher prices than the competition, in situations when its products/services have greater value for the customer, have higher quality, are more prestigious, are more appropriate and more reliable that competitors' ones. For example, the German manufacturer of office furniture, Klöber GmbH, has offered luxury chairs under the brand *Cronos,* priced from $1100–$3000. Within a year, approximately 10,000 customers have bought these chairs, even though they were 10 times more expensive than ordinary chairs. Customers have appreciated the stylish design, the mechanism for customer adaptation by weight and the tilt adjustment of wheelchair Cronos (Edelman, 1996).

Pricing Based on Customers A company during pricing its products can also use their own customers. Companies typically use these techniques because through them, they can see the product value from the customers' perspective. Sometimes companies, through these techniques, have set higher prices in comparison with those set by themselves—without consulting customers. Among these techniques belong (Jobber & Fahy, 2003, p. 167):

- *Conjoint analysis.* According to this technique, as the characteristics and benefits of a product are presented and described to customers, from them is required to set a price for that product. Namely, from the customers is required that based on the product's features and needs/desires/demands that this product satisfies—how much they would be willing to pay?!
- *Experimentation.* A product/service, according to this technique, is distributed across several locations and offered at different prices. In all locations is offered the same product, without any distinction, for customers with similar features and preferences, are organized same promotional campaigns and so on, and in the end marketers analyze in which location are sold more products/services, respectively, which price was more acceptable to customers. Then, that price is set as a product/service's selling price in all locations where it is offered.
- *Economic value to customers.* The economic value of a product for a customer is usually associated with the benefits and reduced costs of using that product, compared with competitors. For example, in the market can be launched a mobile phone battery that needs to be charged every 3 days and can be used longer. Other batteries seek to be charged every single day and can be used shorter. The average price of competitive batteries is 50 €. Differences in charging and use of the new battery, compared with competitors' batteries represent an economic value to customer. If the new battery is rarely charged, the customer will save 6 € for electricity. Then, if it can be used for a longer period than the others (it is with higher quality), the customer will save 10 € as repairing costs. According to this technique, the price of the product would be determined as follows:

[1]	Price of competitive batteries	50€
[2]	Saving from electricity	6€
[3]	Saving from repairing	10€
	Price of new battery	66€

Accordingly, companies that succeed to produce products with higher economic value to customers may allow themselves to set higher prices than the competition.

Marketers can use three pricing strategies: skimming, penetration and competitive pricing strategy. *Skimming pricing strategy* means determination of higher prices compared to the competition. Companies use this strategy mostly in the penetration phase (launching) of the product in the market, because then the competition is too small or does not exist at all. The purpose of this strategy is that, through higher prices, the R&D costs to be recovered faster. *Penetration pricing strategy* is based on setting of lower prices compared to the competition. The purpose of this strategy is to penetrate to market in a shorter time, generate higher sales and realize a larger market share. This strategy, in the 1990s, enabled to IBM to cover 85% of the computer market (Koprowski, 1995). According to *competitive pricing strategy*, the company determines the price of its products/services at the competitive prices' level. The competition is fought through the other elements of the marketing-mix, by offering higher quality products/services, by using better distribution channels that enable a faster providing of products/services to the customer and by compiling an attractive and aggressive promotion program to attract customers.

5.3.3 Distribution

Once a product has been produced and the price has been set, the marketers should find the best way to distribute the product to customers. *Distribution* (somewhere treated as 'place') includes the providing of the product/service in the right quantity, right place and right time. Distribution provides utility to the consumer; that is, it makes a product convenient to purchase. Products/services can be distributed to customers directly and/or indirectly. Most manufacturers do not sell their products directly to customers, but they do that through various intermediaries. These intermediaries that complete the product/service distribution route—from producer to customer—are known as marketing distribution channels. Based on the number of intermediaries between the manufacturer and the customer, there are four types of distribution channels: (1) *zero level channel*—the company directly sells its products/services to customers through door to door, internet, mail and telemarketing; (2) *one level channel*—includes one intermediary, for example, a retailer;

(3) *two level channel*—includes two mediators (wholesaler and retailer) and (4) *three level channel*—includes three intermediaries (wholesaler, retailer and agent).

If the market for a new business is highly concentrated, such as a major metropolitan area, the entrepreneur may consider direct sales to the customer or to a retailer rather than using a wholesaler. If the market is dispersed across a wide geographic area, the cost of direct sales may be prohibitive and the use of a longer channel with wholesalers and retailers may be necessary. Attributes of the product also affect the channel decision. If the product is very expensive, perishable or bulky, a more direct channel would make sense because the costs of handling and shipping would drive the costs up to a prohibitive level.

Relevant activities that are related to distribution channels are those of physical distribution, such as: transportation, storage, inventory management and order processing. *Transportation* involves the movement of products from the seller to the buyer through various types such as trucks, rails, air, water and pipelines. In 2011 in the US, these types of transportation were used as follows: tracks 40.2%, rail 26.1%, pipelines 17.5%, water 7.1%, and air transportation 0.2% and others 8.9% (Bureau of Transportation Statistics, 2011). Choosing the appropriate type of transportation should be grounded in these criteria: cost, speed and flexibility of goods (Table 5.3). *Storage* includes maintaining and securing the products until they be sold or transferred to another place (country, city, market). Storage can be realized through public or private warehouses. Public warehouses are businesses that rent space and additional services to companies. The companies pay rent only for the used space and for the received services. Some companies see more reasonable to have their private warehouses as they enable better control over their goods. *Stock management* means storing a certain quantity of products in order the company does not remain without products at a time when the customer needs them. Manufacturing of some products is more effective if they are produced in larger quantities, but on condition of achieving balance between the costs for storage and maintenance and earnings realized from the sale of those quantities. *Order processing* includes taking orders by phone, e-mail or fax; informing the production/sale personnel about the received order; controlling inventory to be ensured that the ordered goods are in stock; preparing the needed documentation (invoice); and receiving the payment from the customer for the ordered products.

In some instances, it may be necessary to use more than one channel to service customers more efficiently as well as increase sales potential. Clothing retailers, for

Table 5.3 Criteria for selecting the type of transportation

Type of transportation	Costs	Speed	Flexibility
Air	Very high	Very fast	Low
Water	Very low	Very slow	Very high
Trucks	High	Fast	Medium
Rail	Medium	Medium	High
Pipelines	Low	Slow	Very slow

example, Sports Authority, L.L. Bean, Macy's, Walmart and Target, all sell their products using multiple channels such as retail stores, websites, catalogs and newspapers. Each of these may require a different communications channel to enable the customer to buy the desired products. These channels will also vary when engaged in international sales as the nature of these channels is sometimes culturally dependent. Channel decisions will also change over time. As the company grows, the entrepreneur may find that hiring their own sales force is more efficient and is no longer cost prohibitive.

5.3.4 Promotion

Promotion is the fourth element of the marketing mix, which primary task is to inform customers about the product's availability and to persuade them that the respective product is better than those of competitors and they should buy it. Promotion enables companies to communicate with customers. Promotion of a product/service can be accomplished through several forms (promotional mix), such as:

1. ***Advertising*** presents any activity which function is to inform customers about any new product/service through mass media and to persuade them to buy/use it. A company pays a certain amount of money to media for the space and time used for informing the customers about its products and/or services. A well-organized advertising creates a perception that the company offers quality products and services, increases customer loyalty and leads to continual purchases. There are several types of advertising (Churchill Jr & Peter, 2003): (1) *product advertising* focuses on creating demand for certain product/service, place, person and/or event; (2) *institutional advertising* promotes a name, image and reputation of a company, organization or industry; (3) *pioneering advertising* tends to create demand for a category of products, such as dairy products, meat or plastics, and not for a specific brand; usually it is related to new innovative products; (5) *comparative advertising* compares a company's brand with the competitors' ones by presenting its distinguished features that make it superior in comparison with the other; (6) *advocacy advertising* communicate a viewpoint of businesses and other organizations about any controversial topic related to political, social or economic environment. Advertising can be realized through different media, such as television, radio, newspapers, magazines, billboards and Internet.
2. ***Personal selling*** enables direct, personal communication between buyers and sellers. This includes communicating face to face, by phone, e-mail or fax. Personal selling enables immediate response from the customer, which allows retailers to adapt communication in accordance to customer's personality, needs and demands. Namely, the salesperson's ability to adapt is the key of success in

this form of promotion. Personal selling is one of the most expensive forms of promotion.

3. ***Sales promotion*** usually enables increase of sales in a short term. It is used for those products to which customers are not loyal. The customers decide to purchase them in a shop, which means that there is no prior planning to purchase them. As most used forms of sales promotion are: discount, coupons, prize games, gifts (associated with a product purchase, for example if you buy a pack of Coca-Cola you get a free glass), samples, special offers (for example, if you buy 3 Nestlé chocolates you get one for free, etc.).
4. ***Publicity*** is a non-paid-for form of promotion. Common types of publicity are news stories, comments, and interviews from various journalists and very often, without consent of the company. Publicity plays a positive role, because it is done without knowledge of the company, it is not paid like an advertising activity and customers believe in received information. However, publicity may have negative impact as well, if the news and stories are detrimental for the company or its products.
5. ***Public relations***. The audience represents every group that has direct or indirect, potential or actual impact on the accomplishment of the company's goals and objectives (citizens, media, institutions, government, etc.). Public relations involve programs and plans that generate positive relations with the general public and protection of the company's image. Public relations involve press releases, announcements, lobbying, publishing annual reports, offering services from entrepreneurs/managers as guest speakers, hosting events, etc.
6. ***Direct marketing.*** Direct marketing represents direct communication, with no involvement of intermediaries between company and customers. It is realized through websites, interactive TV programs, telephone (telemarketing), direct mail, catalogs and kiosks.
7. ***Events and experiences.*** The company can promote themselves by organizing or sponsoring various sports, cultural, education and similar events and activities.

In order promotion activities to be realized, companies must firstly define the necessary budget for their successful implementation. Defining the promotion budget is quite challenging for marketers, because there is no standard that determines exactly how much should be spent on advertising or personal selling and how much on other promotion forms. Five common methods for determination of promotion budget can be used (Kotler & Armstrong, 2015; Lancaster & Withey, 2007; Lane, King, & Russell, 2004; Middleton, Fyall, Morgan, & Ranchhod, 2009):

- ***Affordable method***. Base on this method, the company determines the amount of money that can afford to spend on promotion. This method is usually used by small businesses. Given the limited financial means, it is not considered whether the company can achieve the marketing objectives (entering into a new market or increasing the participation in an existing market).
- ***Percentage-on-sales method***. This method of promotion budgeting is based on specified percentage of current or anticipated level of sales. For example, a

company decides to allocate 10% of anticipated sales on promotion for 2017. If a company anticipates $300,000 in sales, then $30,000 ($300,000 × 10%) will be used for promotion.

- ***Competition-based method***. In order to determine the promotion budget, some companies are based in the competitors' budget. They see how much money competitors have allocated for promotion and then determine their own budget. It should be mentioned that it is difficult to obtain accurate information about the competitors' promotion budget, because almost none of them publishes such data.
- ***Fixed-sum-per-unit method***. This method means that companies determine the promotion budget based on produced/sold units of respective products. For example, a company can allocate a fixed amount of $15 for every sold unit of a product. If the company predicts that next year will sell 10,000 units of that product, then the promotion budget will be $150,000 (10,000 units × $15).
- ***Objective-and-task method***. According to this method, firstly, companies should define specific objectives they want to achieve through promotion (e.g., 15% increase of sales); secondly, they should determine forms of promotion that will be used and what tasks each should perform; thirdly, they should determine costs of each assigned task; and finally, they collect the costs for each task and the sum of these costs is the promotion budget. Application of this method is too difficult, since there cannot be defined exactly and explicitly what promotion form and task can lead to promotion objectives' achievement.

5.4 Entrepreneurial Marketing

Studies about entrepreneurial marketing assume that began over three decades ago, and focusing on the elements that connect these two concepts, namely the year 1982, at a conference at University of Illinois, Chicago, organized and sponsored by the *International Council for Small Business* and *American Marketing Association* as the two largest professional and academic organizations in these areas, and from 1999 began to publish the first scientific journal that treats issues of entrepreneurial marketing, titled as the *Journal of Research in Marketing and Entrepreneurship* (Ioniţă, 2012). The question is where entrepreneurial marketing differs from traditional marketing?! The main differences are summarized in Table 5.4.

Stokes (2000) differs entrepreneurial marketing from traditional marketing in these dimensions:

- In terms of ***business orientation***, it is concluded that, unlike traditional marketing, which is customer-oriented, entrepreneurial marketing is oriented towards entrepreneurs and innovations. More specifically, if the traditional marketing's concept requires assessing market needs before developing a new product, entrepreneurial marketers start with an idea, which convert it to a new product or service and then try to find a market for it.

Table 5.4 Differences between traditional marketing and entrepreneurial marketing

Traditional marketing	Entrepreneurial marketing
An essentially reactive stance with respect to the external environment	The firm attempts to influence or redefine aspects of the external environment
Marketing strives to follow customers	Marketing strives to lead customers
Serving existing markets	Creating new markets
Focal point is efficient management of the marketing mix	Focal point is new value creation for the customer through relationships, alliances, resource management approaches, and the marketing mix
Risk is to be minimized	Risk is necessary and marketing's job is to manage the firm's risk profile in a calculated fashion
Marketing as an objective, dispassionate science	While acknowledging value of science and learning, recognition is given to the roles of passion, zeal, and commitment in successful marketing programs
Reliance on proven formulas and established rules of thumb	Psychology of challenging commonly shared assumptions
Marketing supports the innovation efforts of other functional areas of the firm, most notably R&D	Marketing is the home of the entrepreneurial process in the organization
Marketing as a functional silo	Marketing as a cross-disciplinary and inter-functional pursuit
Promotion and customer communication receive the greatest amount of attention from marketers	The relative investment or resources in different areas of the marketing mix is context specific
Scarcity mentality, zero-sum game perspective on resources	Opportunity is pursued regardless or resource controlled; philosophy of resource leveraging is paramount
Heavy dependency on survey research	Skeptical use of conventional research; employment of alternative methods (e.g., lead user research, 'backward' research)
Marketing facilitates transactions and control	Marketing facilitates speed, change, adaptability, agility

Source: Based on Morris, Schindehutte, and La Forge (2001, p. 35)

- In terms of ***collecting information*** from the market, entrepreneurial marketers are aware of the importance of monitoring the marketing environment. But they use informal methods, such as personal observation or gathering information through their networks or contacts. They oppose formal research methods as a logical consequence of the fact that they do not believe in the ability to predict the future.
- From ***a tactical perspective***, entrepreneurial marketing does not fit to the model of the 4P's, because entrepreneurs have developed an interactive marketing approach, which is based on personal and direct contacts with customers. Entrepreneurial marketers interact with customers in personal selling and other

marketing activities. Important to entrepreneurial marketing are word-of-mouth and references from customers.

- From a ***strategic perspective***, traditional marketing requires a top-down approach, a clearly defined order of activities, such as segmentation, targeting and then positioning. Entrepreneurial marketers practice an opposite approach, i.e., bottom-up. As they identify a potential market opportunity, they test it through the 'trial and error' process and after that, the company starts to satisfy the needs of some clients, and then began to expand through direct contact with customers and finds out their needs and preferences. Later come new customers with a similar profile to those who have purchased the product earlier. This process often is realized accidentally, as new customers come as a result of recommendations of the previous ones.

But, what in fact entrepreneurial marketing is?! Several definitions can be found in the literature. As most exploited is the following. *Entrepreneurial marketing* represents: "proactive identification and exploitation of opportunities for acquiring and retaining profitable customers through innovative approaches to risk management, resource leveraging and value creation" (Morris, Schindehutte, & La Forge, 2002, p. 5)

This definition itself incorporates *elements of entrepreneurship*, such as: proactiveness, risk-taking opportunity and innovation, and *marketing elements*, such as: customer focus, resource leveraging and value creation. Therefore, it can be concluded that entrepreneurial marketing consists of these six elements (Fig. 5.2):

- ***Customer-intensity.*** Customer-intensity includes the enthusiasm, passion, zeal and belief in where marketing is attempting to take the company and how will do that. This element strengthens the passion for the customer and the employees' identification with products and services, as the core values of the company.
- ***Continuous innovation.*** This element has to do with the ability of the company to continuously provide or produce creative ideas, which will be converted into products, services or new processes.

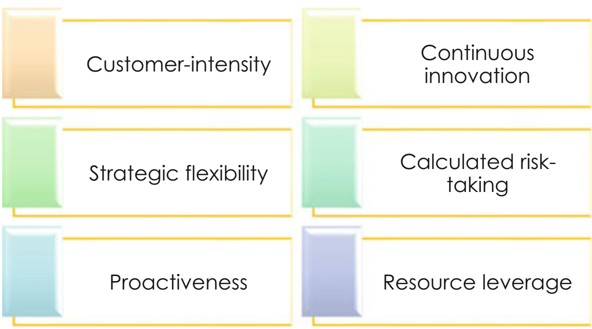

Fig. 5.2 Entrepreneurial marketing elements. **Source:** Based on Morris et al. (2001, 2002)

- ***Strategic flexibility.*** This element is related to the willingness of the company to continuously review and adjust its strategies, action plans and methods of resource allocation, and structure, culture and management systems of the company as well.
- ***Calculated risk taking.*** Risk taking involves the willingness to pursue opportunities that have real chances to generate reasonable loss or significant performance inconsistency. An entrepreneurial marketer does not take uncontrolled risks that can be fatal for the future of the company, but he takes risks that can be calculated and continuously tries to find ways to control the factors that contribute to the risks' appearances. Simply said, they are too vigilant in decision-making.
- ***Proactiveness.*** Entrepreneurial marketers do not take the external environment, as a given or as a set of circumstances in which the company can only be adapted. The environment is perceived as a horizon of possibilities. More specifically, marketers try to redefine the elements of the external environment in order to reduce the uncertainty of the environment, reduce dependence and vulnerability of the company, and/or modify the environment in which the company operates.
- ***Resource leverage***. In essence, leveraging means 'doing more with less'. The word 'lever' describes a metal or wooden stick that allows a person to remove an object that cannot otherwise be moved. Similarly, entrepreneurial marketers represent an excellent lever for efficient resource management. In their companies, usually ambitions exceed resources. Entrepreneurial marketers are not limited by the resources they currently control or have at their disposal. They are able to leverage resources in different ways, such as to use resources much longer than others have used in the past; use resources that others are not able to see them as resources; use the resources of other people or companies to fulfill their goals; blending one resource with another resource to create a greater combined value; and use of existing resources to control other resources.

5.5 Entrepreneurial Marketing Types

5.5.1 Guerrilla Marketing

As it was mentioned in the opening profile, the term 'guerrilla marketing' for the first time was invented in 1984 by Jay Conrad Levinson—the father of guerrilla marketing. This kind of marketing includes a variety of marketing techniques that are attractive, unique, non-traditional, not seen earlier, special, characterized by very low cost and great impact, which enable entrepreneurs to achieve their business goals. Guerrilla marketing can be considered as a predecessor of other entrepreneurial marketing concepts. (Levinson, 1984). It is supposed to be "surprising, efficient, rebellious, infectious, and in the best case even spectacular, thereby bursting through conventional perceptions and leading to a "'wow factor'" (Kraus, Harms, & Fink, 2010, p. 31).

It should be emphasized that guerrilla marketing, in terms of marketing elements (product, price, place and promotion), focuses more on promotional activities and tools (70%), and less on other elements of marketing (10% each). Initially it was meant exclusively for small businesses, but today it implemented by many large companies. Guerrilla marketing activities usually are performed only once, unique and limited to one particular event—if they will be repeated, often lose their effect.

5.5.2 Ambush Marketing

The term "Ambush marketing" was coined in 1980s by the marketing strategist, Jerry Welsh, while he was working for American Express. It comes from the French word *embuschier* which means 'to place in a wood', while in the marketing expression, it means 'an attack from a hidden position'. Ambush marketing is closely related to sponsorship of major events and it is most common in sport (Winter/Summer Olympic Games, FIFA World Cups, NFL Super Bowl, etc.). Ambush marketing is described as intentionally attacking a competitor's official sponsorship in an "effort to gain market share, and to confuse consumers as to who is the official sponsor" (Sharma, 2015, p. 12). Meenaghan (1994, p. 79) define ambush marketing as "the practice whereby another company, often a competitor, intrudes upon public attention surrounding the event, thereby deflecting attention toward themselves and away from the sponsor". It is supposed that ambush marketing was occurred for the first time in 1984 at Los Angeles Summer Olympics, where Fuji was the official sponsor, but Kodak, ambushing Fuji, sponsored the event's TV broadcasts and the official film of the US track team. Today, there are many *pro* and *contra* opinions toward ambush marketing. Some people say that it is an illegal and unethical way of marketing, some others say that it is a creative strategy. These issues are broadly discussed in Nufer (2013).

The common reasons why some companies use ambush marketing are the following (Agrawal & Byahatti, 2013, p. 8)

- To create an impression of being an official sponsor without paying for it;
- To counterbalance the Olympic commitment of market competitors;
- To set right the campaigns of the sponsors that are misleading;
- If securing sponsorship rights is too expensive or the category is blocked, ambushing is used;
- To be able to use the money saved by not becoming a sponsor, on advertisements.

Crompton (2004) identified seven ambush marketing strategies: (a) sponsoring an event broadcast; (b) buying advertising time in and around an event broadcast; (c) sponsoring properties associated with an event; (d) capitalizing on advertising media available in proximity to stadia and host venues; (e) advertising using a theme or implied association with the property; (f) creating a competitive attraction or parallel property; and (g) accidentally ambushing an event.

Nike is the king of ambush marketing. Reebok was the official sponsor of the Dream Team in 1992s Olympics. Nike organized a press conference with Dream Team players, who covered up the Reebok logos on their tracksuits with American flags. The FIFA World Cup in 2010 in South Africa was sponsored by Adidas. Shortly before the event, Nike put out a lengthy online viral video featuring many of the players. Then, Nike put up an interactive installation in the fourth tallest building in Johannesburg, known as 'Life Center' (138 m tall), flanked by 90 meters tall images of Cristiano Ronaldo and Robinho (Minato, 2012).

Kulula, a South African no-frills airline, used the FIFA World Cup event to organize an ambush campaign, where they offered "affordable flights to everybody except Sepp Blatter. . .He can fly for free". Sepp Blatter, the President of FIFA, did not accept their offer, but one South African did by officially naming his dog as Sepp Blatter and gave the opportunity to Kulula to organize a press release proudly stating "It's official: Sepp Blatter flies with us" (Nufer, 2013).

5.5.3 Buzz Marketing

Buzz marketing is another type of entrepreneurial marketing, where a certain product/service is promoted by one person to another, without the knowledge, order, help or supervision of the company. It is known as a word-of-mouth communication. According to Morrissey (2007, p. 14), buzz marketing is "like a virus, it is ideally spread with a predefined target which will relay the message to the people who love surrounding the same products and services that carry the message." The idea of buzz marketing is to spread information to customers through the organization of an event or an activity, in a spectacular, surprising and memorable way. This event or these activities should be closely associated to a brand. A good activity creates 'buzz' and media coverage. It should create a reaction that attracts attention, be something 'dangerous', controversial or provocative (*see:* http://eunsolchoi.blogspot.mk/2010/02/buzz-viral-marketing-and-word-of-mouth.html). Buzz marketing is distinguished by higher effectiveness in comparison with other forms, because people more trust to the information received from their family members, friends, colleagues or neighbors, than those received from a company. According to a study in the US, more than 67% of product/service's sales were realized as a result of buzz marketing (Dye, 2000).

The Blair Witch Project is a low-budget movie that was filmed in 1999. Internet was chosen as a medium to create word-of-mouth communication for the movie. The producers initiated the rumor that the three college film students, the original film-makers, have disappeared while hiking in the Black Hills near Burkittsville, Maryland, and that the movie contains the last shots the three had made with their camera. A lot of people asked themselves, accompanied by a background documentary on the American Sci-fi Channel, what might have happened to the students. IMDB.com proclaimed the students "missing, presumed dead". *The Blair Witch*

Project, the movie that was filmed for $35,000, for a short period of time became a world-wide box office success—grossing $248 million. An ensuing Hollywood sequel cost about $15 million, but only earned $26 million in United States. USA Today noticed that *The Blair Witch Project* the first movie to go 'viral'. (Kraus et al., 2010).

5.5.4 Viral Marketing

Viral marketing is a new form of entrepreneurial marketing that is closely related to the development of internet. This kind of marketing involves the transmission of information from a person to many others via internet. This is the reason why it is usually known as "word-of-mouse" marketing. Through viral marketing the information can be disseminated quickly to the wide audience and needs very little efforts. Viral marketing's success depends on the desire, will and personal benefit of the customer to further distribute the information to his network, such as family, friends, colleagues, neighbors, etc. If this'sparks', then the company can promote its products or services to a wide audience without any costs. It should be mentioned that, as buzz marketing, viral marketing as well can have negative effects on company's image—if the shared message includes information on products or services in a negative sense. Viral marketing's features in comparison to those of buzz marketing are presented in Table 5.5.

With limited budgets, many entrepreneurs who need to be creative in their promotions are turning to social media. For example, Quintin Middleton was convinced that there was a market for American-made carving knives. Out of his home, this initial hobby of crafting high-quality knives has turned into a successful business that targets chefs. Invites on Facebook to about 800 people in the food industry resulted in 400 fans, many of whom were willing to pay Middleton $300–400 for a custom knife. He is now selling these custom knives as fast as he can make them (Littman, 2011).

5.6 Summary

This chapter has focused on the entrepreneurial marketing essentials. Following the discussion of the core marketing concepts, the major elements of a marketing were discussed—product/service, price, distribution and promotion. The chapter concluded by discussing the major types of entrepreneurial marketing, such as guerilla, ambush, buzz and viral marketing.

Table 5.5 Comparison between buzz and viral marketing

Buzz marketing	Features	Viral marketing
Buzz is the aggregate of all communication about a certain product that is propelled through grassroots activities among people at any given time	Definition	Approach that encourages individuals to pass on a marketing message to others, creating the potential for exponential growth in the message's exposure and influence
Consumer-generated information dispersal through individual network hubs, i.e., friends/colleagues or mega-hubs like Oprah Winfrey and Rosie O'Donnell	Principles	Process whereby an idea spreads like a virus, catching strength, multiplying and mutating as like-minded people market to one another
Creating and leveraging a "buzz" by generating excitement, infatuation, and missionary zeal	Strategy	Self-replicating promotion, fanning out across community webs
Credibility of source Effective and efficient	Advantages	Cheap, easy, and powerful Transmit ideas quickly and easily
Network marketing, i.e., use face-to-face interaction with personal networks	Medium	Internet strategy, i.e., use e-mail website, software download
Sustain excitement Generate demand Create customer loyalty	Objective	Create a message, send it via e-mail, and make it so compelling that recipients want to pass it on to everyone in their address book
Use virtuous cycle of "word of mouth"	Tools	Use exponential power of "word of mouse"
Challenge of translating "buzz" into sales Loss of control (message, timing, audience, etc.) Difficult to measure	Risks/ Disadvantages	Annoying e-mails More clutter Potential for backlash
Cross-promotions (e.g., movie product placement) Place-based promotions Sponsorships (association with desirable event)	Tactics	Give away product/service (e.g., free e-mail) Utilizes existing communication networks Exploits common motivations and behavior
PalmPilot, iMac, Blairwitch Project, Fedex, BMW Z3 Roadster	Examples	Hotmail.com, Ebay, Napster, Yahoo, Blue Mountain Arts, Geocities, Google

Source: Based on Morris et al. (2001, p. 34)

Case Study: Layar and Its Augmented Reality Platform

You are flipping through a magazine and turn to a one-page advertisement for hiking boots. The corner of the page asks you to download a free app on your smartphone and then point your camera at the page. You open the app, and then aim your camera phone at the ad. On your screen, you still see the table

(continued)

in front of you and the magazine is still resting on top. The only difference is the huge virtual, three-dimensional hiking boot popping out of the magazine. If you slide the magazine around the table, the boot moves with it. You can look at every side of the boot as if it were really there. Bring your camera in closer, and you can even see the boot's immaculate stitching.

Augmented reality is not a new idea—sci-fi movies and books have used this virtual notion for years. But thanks to firms like Dutch start-up, Layar, augmented reality is quickly becoming the global reality for businesses vying for consumer attention. In 2009, a team of tech-savvy colleagues came together in Amsterdam and launched Layar, a tech company centered around its augmented reality platform targeting mobile application developers. Claire Boonstra, Maarten Lens-FitzGerald and Raimo van der Klein had already shared their mutual infatuation with tech innovation during their formative years. The three had previously worked together in the Netherlands, setting up networking events for locals interested in wireless-related technology. Soon after, the group decided to pool their technology passion with their collective skills in civil engineering, marketing and web-related technologies to create Layar's platform software. Boonstra, Lens-FitzGerald and van der Klein used a mixture of funding, including venture capital funds for Layar's initial years. Layar provides use of its platform to companies revamping their marketing strategies to keep up with their technologically advancing customer bases.

One of the first companies to use Layar's platform developed an app that allows its users to aim their camera phones in any direction and see virtual bubbles pop up over homes marked for sale. Each bubble, when touched on the screen, is linked to the home's listing information. Another one of Layar's first customers was a local Dutch bank that allowed its customers to aim their phones in all directions and see virtual circles pop up over their ATM and branch locations. Layar now deals with hundreds of mobile app developers from different industries, guiding other companies in their search for more interactive and customer-engaging marketing ploys. Layar's platform and the app developers who use it are now coming up with new virtual advertising ideas. Magazine readers can view pop-up videos on magazine pages. Virtual three-dimensional furniture explodes out of its print ad and moves around to show how its pieces can be adjusted. Not only is Layar's software paving the way to a futuristic mode of marketing but it is also creating a resurgence in the lost art of print advertising, a strategy dumped by many companies due to its expense and growing obsolescence. And while other tech companies have jumped onboard to create their own similar platforms (some businesses are even developing their own virtual advertising platforms in-house), Layar prides itself as one of the first in its industry to successfully commercialize

(continued)

its technology, and remains a top international player in virtual mobile app development.

Assignment

1. Putting yourself in the role of a marketing consultant, prepare an entrepreneurial marketing plan for the Layar's executives!

Source: Based on Hisrich (2014, pp. 151–152)

Questions for Discussion

- What are the main tools of marketing? Discuss them shortly!
- Explain the product-mix and its four dimensions: width, length, depth and consistency!
- Discuss the methods that entrepreneurs use to set the products/services' price! Give some examples!
- Describe shortly the promotional mix forms!
- Describe shortly the five common methods for determination of promotion budget!
- What do you understand with entrepreneurial marketing? Discuss its six elements!
- Explain guerilla, ambush, buzz and viral marketing! Find some examples in Internet!
- What are the main differences between traditional and entrepreneurial marketing?

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Organizing an Entrepreneurial Venture 6

Learning Objectives
***After reading this chapter, you should be able to*:**

- Understand the reasons for using a specific legal form of business.
- Know the types of legal forms available and their aspects
- Understand Board of Advisors and Board of Directors and their use.

Profile: Kumri—Building a Business, Building a Country
In Tajikistan, women often joke that they "don't have husbands, only names of husbands". This is because each year several 100,000 men leave Tajikistan for Russia in hopes of finding work that will feed their families back home. Kumri Orifova and her sisters found themselves in this situation when unemployment rose after Tajikistan gained its independence from the U.S.S.R. in the early 1990s.

Kumri has a university degree, and before Tajikistan gained independence she had worked for many years as an accountant at a Soviet-run sewing factory. For the most part she enjoyed the work. However, in the early 1990s the Tajik government took over management of the factory, and with a civil war waging, the factory did not receive enough funding or support to continue operating—after several years, the government stopped funding the project altogether. Kumri's husband and her sisters' husbands left to find work in Russia, and Kumri found herself unemployed and responsible for her three children and her husband's aunt.

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R.D. Hisrich, V. Ramadani, *Effective Entrepreneurial Management*, Springer Texts in Business and Economics, DOI 10.1007/978-3-319-50467-4_6

For many, this is where the story would take a turn for the worst. In Kumri's story, however, this is where she began to show what a determined woman is capable of.

Kumri decided to start her own sewing business, immediately convincing her two sisters, Farogat Muhamadova and Sharifa Kosimova, to join her in the venture. Instead of operating the business as three joint owners, they operate more like a cooperative—each has the ability to invest in and profit from their own financial decisions. They started small, borrowing enough money from friends and family to rent a space and a few machines—eventually reinvesting the profits to purchase the machines outright. They were able to find enough work to hire an additional 4 sewers, all of whom were related to the sisters in some way. They have contracts with several local factories to sew uniforms, but are also able to devote some of their time to sewing the national dress for women in their community.

The business was successful, so 4 years ago Kumri decided to branch out. She joined with a few other investors to purchase a weaving factory so that her sewing factory could source fabric at a cheaper price, without having to pay a middleman. They found a factory that employed blind weavers and had suffered a similar fate to her previous employer; after being started by the Tajik government as a way to provide jobs and housing to legally blind adults from all over the country, its doors were closed after economic hardships hit. Kumri and her business partners were now in ownership of a successful sewing factory and a weaving factory that employed 40 blind men and women.

Even with a direct supply of fabric at cost, the full potential for Kumri's enterprise had not yet been reached. The sewing machines she had were old, and Kumri believed they could increase production if they had new machines. About six months ago Kumri and her sisters received their first business loans from IMON International, a Kiva Field Partner since December 2007. Kumri and Farogat each took out loans for \$600, and they used this money to purchase three new sewing machines, phasing out some of the older machines that had become too difficult to use. Even they were shocked by the impact of such a small loan: the factory went from sewing 10 uniforms a day to 50. And after only a few months of this increased productivity, Kumri and her sisters were able to secure more factory contracts and hire three more sewers. More sewers mean more contracts. More contracts mean more fabric. And, hopefully, more fabric means more work for the weavers as well.

While Kumri refers to the business as a factory, it is not much more than a big room crammed tightly with sewing machines, bolts of fabric, and a large cutting table. The large windows that line all four walls of the space do little to stop the wind and cold air from pervading the space—even on a sunny Fall day, the sewers were struggling to stay warm. A small coal stove in the

(continued)

middle of the room was the only source of heat and was a popular gathering spot during Tajikistan's harsh winter. The women are only able to sew for about an hour at time, stopping for 20 min breaks to warm their hands.

Kumri and her sisters eagerly talk about their future plans for the business. Each month, they set aside 5–10% of their salary, so that they eventually hire more sewers and finance their business' expansion. They have big plans to open workshops in other towns in the region.

Just 5 years ago, they were trying to create jobs for themselves but now they are excited by the possibility of creating jobs for others in Tajikistan. In fact, when they talk about business growth, they don't mention their own personal profit, but instead count how many jobs they were able to create.

Kumri initially started working with blind people in order to get a tax break which the government provides to employers of people with disabilities. But, now she is really excited about the prospect of continuing to work with disabled communities. She is very upset that Tajikistan does not have access to industry or to work, that men are forced to leave their families and find work in Russia, and she is now focused on continuing to grow her business so that she can create more jobs for Tajikis, right here in their own community. She sees her work as a way to improve life in Tajikistan.

Source: KIVA entrepreneur profiles (https://pages.kiva.org/press/entrepreneurs#kumri). Published with kind permission from KIVA.

6.1 Introduction

The major focus of this chapter is the legal form of the organization and the organizational structure of the new venture. The chapter begins with a discussion of the reasons for selecting one legal form over alternative forms. Then, the chapter focuses on the legal forms of business available in the United States. The chapter concludes with a discussion of Board of Advisors or a Board of Directors.

6.2 Reasons for Forming a Specific Legal Form of Business

There are many different legal forms of business available which differ on a country by country basis. The factors affecting the choice of one legal form over another include: taxation policy; number of employees now and in the next 10 years; level of legal liability; and the type of firm and product area.

1. ***Taxation***: The level and type of taxes varies with the type and company formed and the country's laws. This is probably the or one of the most important factors in the choice of the legal form chosen; while taxation and tax policy can often

keep an entrepreneur or even an existing firm from locating there, sometimes the other factors are more important than tax rate and a different legal form is chosen.

2. ***Number of employees***: The number and type of employees the company will have in the future as it builds its market position is another sector. This includes whether citizens outside the country will need to be hired. The size of the company has a significant impact on the types and costs of the fringe benefits. Besides the usual benefits of retirement, health and dental insurance, other benefits include: training, education, and upgrading knowledge. The fringe benefit package that can be offered vary by the types of legal form used. The fringe benefits of the top management team and owners must also be taken into account.
3. ***Legal liability***: In some countries such as the United States, the extent of legal liability has significantly increased. Sometimes, even an extensive amount of insurance cannot provide coverage and protection. Thus legal liability is involved in the offering (the products or services offered) by the firm, the management team and when present the company's board of directors.
4. ***Type of firm and its industry***: Some industries by their very nature require a certain type of legal form. There are similar organizational forms for accounting, legal, financial institutions, mining, production (service) companies, and high-tech companies. Unless there is a strong case for not using the typical legal form of the industry, it is often better to follow the same legal form already established.

6.3 Types of Legal Forms Available in the U.S.

While there are some different legal forms available in each country, many of them are similar to legal forms presented in this chapter. The overall general organizational structure available in the United States are indicated in Table 6.1. These include Proprietorship, Partnership, LLC, S-Corporation, C-Corporation, Professional Corporation, Non-Profit Corporation, and Hybrid Corporation. There are variations in each of those eight general organizational structure, six of which are corporations.

Table 6.1 General organizational structure in the United States

• Proprietorship
• Partnership
• LLC
• S-Corporation
• C-Corporation
• Not-for-profit corporation
• Hybrid corporation
• Professional corporation

The six corporation forms will be discussed below:

1. ***Limited liability company***: This is the most frequently used organization form as it provides legal protection for the individual as the company is the entity not the individual and there is no double taxation as any income earned by the corporation flows directly to the individual without any taxes or profits. There is a limitation on the number of owner.
2. ***S-corporation***: Another frequently used form of organization form with the same advantages of a limited liability company but limits the number of owners to 100.
3. ***C-corporation***: The organizational form required for C Company to be listed on any stock exchange. The company has double taxation as there is a tax on company income and taxes on the dividends at the individual tax rate.
4. ***Non-profit organization***: This is usually the most different form of organization to establish as the company does not pay taxes on any revenue or donations. The non-profit organization must gift at least 80% of its earned income (revenue) of the year in the United States to retain its Non-Profit status.
5. ***Hybrid corporation***: This is the newest form of corporation where a percentage of income is specified to be given to a non-profit organization or the company's own non-profit organization established. This percentage is carefully monitored for use in an appropriate way.
6. ***Professional corporation***: This organizational structure is set aside for use by professional organizations such as accounting firms and law firms. It can only be used in the case specified by the tax authority.

These eight general organizational structure can as well be grouped into 3 legal groups: Proprietorship, Partnerships, and Corporation. The attributes of each of three general legal groups needs to be carefully evaluated in order to select the best organizational structure for the organization in the specific country. The aspect of each of three general legal forms of business are indicated in Table 6.2 and discussed below:

1. ***Costs of starting a business***: The more complex the organizational form, usually the more expensive it is to file and start. Of the three general forms, the least expensive is the proprietorship as in addition to the filing the only other cost is filing the trade name and any other copyright materials. In addition to filing fee and the costs of filing the trade name and any other copyright material, the partnership form of the company requires a formal document covering all the responsibilities, rights, and duties of each of the partner (the partners) involved. There are two forms of partnership agreements—a limited partnership and a general agreement. The final and most comprehensive general organization form is the corporation. Besides the usual filing costs of the trade name and copyright material, the corporation requires registering the name and articles of incorporation and meeting the statutory requirements of

Table 6.2 Aspects of three general types of business forms

Factors	Proprietorship	Partnership	Corporation
Ownership	Individual	No limitation on number of partners.	No limitation on number of stockholders.
Costs of starting business	None other than filing fees for trade name.	Partnership agreement, legal costs, and minor filing fees for trade name.	Created only by statute. Articles of incorporation, filing fees, taxes, and fees for states in which corporation registers to do business.
Transferability of ownership	Complete freedom to sell or transfer any part of business.	General partner can transfer his/her interest only with consent of all other general partners. Limited partner can sell interest without consent of general partners. No transfer of interest in an LLP.	Most flexible. Stockholders can sell or buy stock at will. Some stock transfers may be restricted by agreement. In S corporation, stock may be transferred only to an individual.
Capital requirements	Capital raised only by loan or increased contribution by proprietor.	Loans or new contributions by partners require a change in partnership agreement. In LLP partnership, entity raises money.	New capital raised by sale of stock or bonds or by borrowing (debt) in name of corporation. In S corporation, only one class of stock and limited to 100 shareholders.
Management Control	Proprietor makes all decisions and can act immediately.	All general partners have equal control, and majority rules. Limited partners have limited control. Can vary in an LLP.	Majority stockholder (s) have most control from legal point of view. Day-to-day control in hands of management, who may or may not be major stockholders.
Attractiveness for raising capital	Depends on capability of proprietor and success of business.	Depends on capability of partners and success of business.	With limited liability for owners, more attractive as an investment opportunity.
Distribution of profits and losses	Proprietor responsible and receives all profits and losses.	Depends on partnership agreement and investment by partners.	Shareholders can share in profits by receipt of dividends.
Liability of owners	Individual liable for business liabilities.	In general partnership, all individuals liable for business liabilities. Limited partners are liable for amount of capital contribution. In limited liability partnership (LLP), there	Amount of capital contribution is limit of shareholder liability.

(continued)

Table 6.2 (continued)

Factors	Proprietorship	Partnership	Corporation
		is no liability except when negligence exists.	
Taxes	An income appears on owner's tax return and is taxed at his/her rate.	Partners usually pay taxes at their individual tax rate on their pro-rata—of income.	No income is allocated to stockholders, just dividends are paid.

Source: Authors' own table based on Hisrich et al. (2017)

the domicile of the company. These costs vary by country and even by state within the United States.

2. ***Ownership***: The ownership varies over the three general organizational forms. In the proprietorship, the owner is almost always the individual who starts the company, since this individual is responsible for operating the company. Sometimes, all or some of the ownership is given to the spouse, children, or someone who has done a lot for the company formation to occur. A partnership can involve general partnership owners and limited partnership owners until the ownership reflected in the number of shares of share of stock in the organization or individual has in the company. Sometimes there is a maximum number of owners in an S Corporation where the maximum number of owners is 100.
3. ***Transferability of ownership***: Transferring all or part of the ownership is very easy for sole proprietorship as the entrepreneur (founder) has the right to sell any part or all of business desired. In a partnership, limited partners have flexibility and can sell their part of ownership in the business without consent of the general partner. General partner usually cannot sell (transfer) their interests to a new party without first offering their interest (ownership) to the other general partner. General partners usually cannot sell (transfer) their interests to a new party without first offering their interest (ownership) to the other general partners. In LLP's, popular among accounting and law firms, the transfer of interest is often not allowed. The form of organization providing the easiest way to transfer ownership is the corporation particularly when the stock is listed and traded on one of the many stock exchanges. This transfer can of course be done without the consent of any other shareholders. When the stock of the corporation is not listed on an exchange, then the valuation and transfer of ownership is more difficult; the present owner needs to determine the valuation and then find some interested party and then determine the price and transferability.
4. ***Capital requirements***: The capital needed to start a company varies by country and the raising of capital varies by the form of organization. New capital for a proprietorship can come from loans from any source or additional capital (or even loans) from the proprietors. In a partnership, acquiring additional capital frequently requires a change in the partnership agreement even if the

new capital is provided by the existing partners. The partners are liable for the payment of any loan. There are numerous ways a corporation can raise capital, more than any other legal organizational forms. Preferred or common stock as well as bonds can be offered. Loans may be obtained by the corporation, not the individual, with the corporation having the responsibility for its repayment.

5. ***Management control***: Each of three general forms of organization offer different possibilities for making business decisions and having control. In a proprietorship, since there is only one owner, he/she has the most control and ease in making business decisions. In partnership, there is some difficulty in making decisions unless there are clearly defined methods in the partnership agreement. Often in a partnership, minor decisions are made by the managing partner with all major decisions requiring a majority vote of all the partners. In a corporation, management decisions and control are usually done by the management. Major long term decisions, however, often require the vote of the stockholders. Usually stockholders elect a board of director which the president (CEO) and all top management report to.
6. ***Attractiveness for raising capital***: Of the three forms of organization, the attractiveness of raising capital is most for the corporation due to the structure and advantages regarding personal liability. Stock, bonds, and any other form of debt can be used when raising capital with limited liability.
7. ***Distribution of profits and losses***: The distribution of profits (losses) also vary greatly by the organizational form. In proprietorship, the owner (proprietor) receives personally all the profits and is responsible for any losses. The partnership agreement in the partnership form of organization specifies how the profits will be distributed and the losses handled. Limited partners can be protected from liability and being responsible for losses in a limited partnership agreement or an LLP.

   Profits are distributed by a corporation through dividends. Losses need to be adsorbed by the company and are not the responsibility of the stockholders.
8. ***Liability of owners***: Owners liability is one of the most critical issues in choosing one of the three general organizational forms. Owners in a corporation have no liability whereas the owner in a proprietorship or partnership do have liability. Given the amount of litigation occurring in today's world this feature alone may be the most important one for using the corporation organizational form. In a partnership, the general partners have the liability which can be protected by insurances. One form is DTO Insurance—directors' and officers' insurance. The same is true for proprietorship.
9. ***Taxes***: There are a lot of differences in the tax structure of any country and the three forms of organizations. Tax policy and rates are one of the most important things to consider in choosing one form over another. Generally, for proprietorships taxes for the business as are treated like the individual owner. There are however some advantages: no double tax where profits are distributed to the owner; no capital stock tax or penalty for retained earnings of the company. A partnership has the same advantages as a proprietorship; the limited partners usually have tax advantages over a general partner. Since the

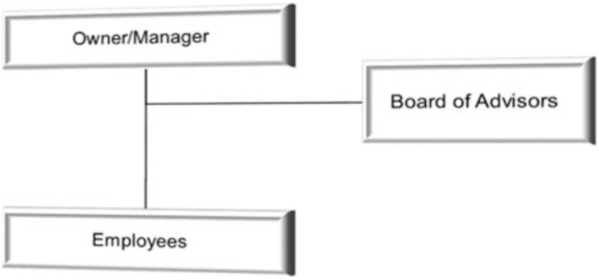

Fig. 6.1 Simple organization structure

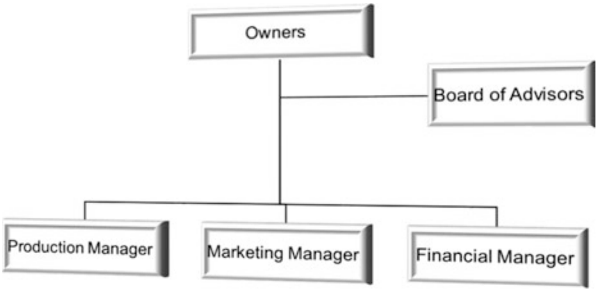

Fig. 6.2 Functional organization structure

corporation is viewed as an individual entity instead of the individual, the corporation can take many deductions and expenses not available to proprietorships and partnership. The biggest disadvantage for corporations (except for LLC and S-corporations) is that the distribution of dividends is taxed as income to the corporations and as income to the individual at his/her tax rate. Since tax laws vary widely by country and state within the United States often a tax advisor should be consulted.

10. ***Organizational structure***: At start up, the initial organizational structure will be simple. If there are employees, it could be in the form of Fig. 6.1. Where there are no employees, the owner/founder will perform all the functions of the organization outsourcing those functions that he/she does not feel capable of performing in the time needed. These functions outsourced are often accounting and production/assembling.

As the work flow and orders increase, more and more individuals will be involved in the organization. This can result in the organizational structure indicated in Fig. 6.2. Usually, as indicated in the figure, there are multiple owners of the organization who have the final say in the direction and operations of the organization.

As the organization continues to grow and add more employees a more complex structure to the organization evolves (Hisrich, 2004). A sample is shown in Fig. 6.3. Often by this time a more formal board of directors is formed particularly if the organization issues an IPO (Initial Public Offering) and is listed on one of the stock exchanges.

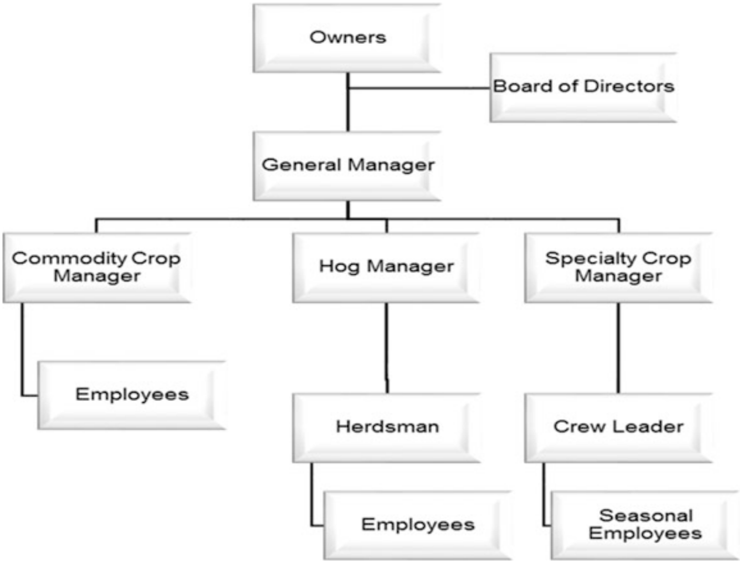

Fig. 6.3 Enterprise or product organization structure. **Source**: Authors' own table based on Hisrich (2004)

The organizational chart as depicted in the organizational chart defines each employees' responsibilities (job) and the relationship and reporting system each job has with each other. A measurement, evaluation, and reward system needs to be established so that each employee is held accountable and is rewarded for successful performance of the job. The owner/manager will also need to establish selection criteria for each job, particularly higher level ones, and develop the appropriate training programs for each job.

6.4 Board of Directors/Board of Advisors

It's important for the successful launch, growth, and exit from the business to establish a Board of Advisors or a Board of Directors. The main difference between the two boards is that the Board of Directors has fiduciary responsibility (legal liability) in the way the organization is run and the Board of Advisors do not. Since a company usually starts with a Board of Advisors due to the difficulty in recruitment and the cost which will be discussed first.

6.4.1 Board of Advisors

The Board of Advisors serves only in an advisory capacity. Each venture should have 2–3 members on the advisory board at the start of the venture and can expand this to 5 members as the venture grows and has different needs.

The selection of the Board of Advisors is important as each member should have a skill or knowledge that is needed at that time. Each board member should be offered a part of equity each year for a 3 years' period. The distribution ¾ of a part will be done at the end of the third year to help ensure that a board member is committed and will be there over a period of time.

Each advisor should be interviewed and carefully assessed as if they were being hired for a position in the venture. The quality of their contribution to the venture and compatibility with other advisors and the management team should be determined. While advisors are definitely needed for small companies they can provide expertise and direction in critical areas for organizations of all sizes.

6.4.2 Board Meeting

Meetings of the board of advisors can take place as frequently as needed and anytime after the formal board meeting, each advisor can be contacted individually as needed. Some advisory groups or individuals can be used as an advisory individual without ever being a member of the board. This includes: banks, other small business, chamber of commerce, accountants, lawyers, and even friends and relatives although the latter two need to carefully selected as frequently friends and relatives can be optimistic and give the advice they think is desired by the management team.

6.4.3 Board of Directors

The Board of Directors is a much more formal group compared to the Board of Advisors and have legal liability for the decisions and operations of the organization. The Board of Directors usually: resolve conflicts between owners/shareholders, review and approve the operations and budgets of the organization, develop long term strategic plans for stability and growth of the organization, monitor the use of assets, and provide information and advice within their area of expertise.

While not always, usually equity investors require seat(s) on the Board of Directors particularly if the investor is more formal in nature such as a venture capital firm. The names of potential qualified board members can be obtained through investors, banks, accountants, lawyers, other business, and/or consultants. The board is usually an odd number such as 5 or 7 to avoid deadlock and a minority of the board can be full time employees of the organization. The CEO/President of the organization is almost always a member of the board. The board needs to meet regularly at least four times each year for a publicly traded company. There should be committees of board such as Personnel, Marketing, and Budget and Audit with the latter one being the most important, having the most responsibility. Guidelines for the members of each committee as well as the members of the Board of Directors are monitored by the rules of the Sarbanes-Oxley Act which became a law in 2002 (see Hisrich, Peters, & Shepherd, 2017).

6.5 Summary

This chapter explored the aspects of organizing the entrepreneurial venture. Several organizational forms were presented and the three general categories (proprietorship, partnership, and corporation) were compared. The chapter concluded with a discussion of types of organizational structures and the role of the Board of Advisors and Board of Directors of the organization.

Case Study: Too Big for His Britches

Confusion

Chad sat alone in his car slightly stunned. "What the heck?" he said out loud. He wondered if he could figure out what had just happened and why. He sat and stared at the two pieces of paper in his hand. He had worked hard, performed well, and offered suggestions for improvements, and termination was his reward! How did that make any sense at all?

Reflection

The bottling plant was owned by a family corporation. Dan Sr. was the CEO and majority stockholder. The business had been divided among the couple's three sons, two of whom were successful businessmen in other parts of the country. Dan Sr. announced that his son would fill the new director of operations position while he learned the business to prepare Dan Jr. to take over when Dan Sr. retired. There were rumors that sooner or later Junior's mother would find a way to use Junior to take the business away from his father. Dan Sr. never talked about that possibility, but he seemed increasingly stressed the longer that Dan Jr. worked at the plant.

The full-timers in the plant did not like Junior much at all, including the head of delivery routes and the head of maintenance. Chad's recollections fast forwarded to three months after Junior's arrival when Sarah, a pleasant highly-competent grandmotherly bookkeeper, was replaced with a young bombshell, Sherry. Chad's only interactions with Sherry were the several times when he asked why his weekly paycheck was made out for fewer hours than he had worked. Sherry's answer was always the same: She would make it up to Chad on the next paycheck, and a few times she actually came through

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on that promise. Several other part-timers had the same problem with Sherry. When one of them complained to Dan Jr., the latter turned bright red and yelled at the worker saying, “She’s doing the best that she can!” That worker was loudly and publicly dismissed by Dan Jr. within a couple weeks for “goofing off.”

No one dared to question Dan Jr.’s actions. Dan Jr. wanted more control over the drivers so he could set higher sales quotas, which he assumed would lead to more sales and more profit for him. He wanted to have a drivers’ meeting each afternoon to indoctrinate them into his new plans for the company, and Dan Jr. always got what he wanted. To implement his plan, Dan Jr. told the part-timers that they needed to load the six route drivers’ trucks each evening. Dan Jr. wanted to implement a new pay structure where the drivers would get a minimum hourly wage if they didn’t reach the quota he had set. Of course, Dan Jr. knew that the drivers would be in an uproar over that intention and would probably take their case to Dan Sr.; therefore, Dan Jr. intended to show the drivers that he was a good a manager by not requiring them to load their trucks for the next day. Surely the drivers would take his side and become his allies.

But this plan had 2 flaws. First, the drivers did not return to the plant at the same time each day, and none of the drivers arrived at the loading dock at the same time as any of the other drivers. The other major problem was that the part-timers had no idea regarding the selection of soft drinks they should load on each truck. Each driver’s route varied each day. The bottom line was that only the driver knew how to load the truck so that the right number of cases of the right soft drinks were in the right spot on the truck to unload at each location. Consequently, the driver had to provide the part-timers with a list of the variety of cases of soft drinks to load as well as a map regarding where to place the inventory on the truck. Obviously, a driver would spend more creating the list and the load map than he would have spent loading his own truck.

Being a problem-solver by nature and having paid attention in his business logistics class, Chad asked a couple of the drivers whether the two problems could be solved if the daily routes were standardized more than what they had been. Then Dan Jr. would have a better idea regarding when the drivers might arrive at the plant, and the part-timers would know what to load on each truck for the next day. One of the drivers thought Chad had a good idea. Another of the drivers just said “Mind your own business, college kid.” Chad was pretty sure that the driver was just kidding, but his comment stung just the same.

Clarity

Alone in his car, Chad shook his head out of the recollection mode as the dots connected. As he started the car and eased away from the curb, he mumbled to himself, “So, my idea finally got back to Dan Jr. At least now

(continued)

I know how I am too big for my britches." But Chad also knew that problems lay ahead for Dan Sr. and for the business. He really liked Dan Sr. and was concerned about the future of this business, but being a "college kid" and a part-timer there was really nothing he could do. Besides, Dan Sr. had decided that Dan, Jr. was going to take over operations of the business. Chad couldn't help but wonder if the business would survive the change in leadership.

Assignment

1. Putting yourself in the role of a business consultant, prepare an organizational plan for Dan Jr.!

Source: This case is written and adapted from the authors based on the information in Hodge and Carpenter (2015: 160–164).

Questions for Discussion

- What factors should you consider when choosing an organizational structure?
- Discuss the types of organizational structure available in the United States.
- Discuss the differences between a Board of Advisors and a Board of Directors.

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- http://www.kiva.org/press/entrepreneurs#kumri
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Raising Capital for the Entrepreneurial Path 7

Learning Objectives
After reading this chapter, you should be able to:

- Understand the enterprise capital market.
- Understand the use of debt versus equity.
- Know how to finance your venture at various stages of development.
- Know how to value your venture.

Profile: Milton Snavely Hershey–Hershey Chocolate Company

Milton Snavely Hershey became a millionaire by founding The Hershey Chocolate Company and the company town of Hershey in Pennsylvania. He was born on 13th September 1857 on a farm in Pennsylvania. Because of the fact that his family regularly moved around, he quit school at the fifth grade and became an apprentice to a printer in Lancaster, Pennsylvania. However, this apprenticeship soon ended because he didn't enjoy the work and he instead began and completed an apprenticeship of 4 years working with a candy maker from Lancaster. When he completed the apprenticeship he then set up a candy making business which initially failed, along with his second and third attempts at establishing candy making businesses in New York City and Chicago.

In 1883 he came back to Lancaster and successfully set up the Lancaster Caramel Company using a recipe for caramel he had come across during his travels. This business allowed him to progress further in the candy making business, beginning his career as a successful businessman.

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Using the money, he made from the Lancaster Caramel Company, he was able to buy 40,000 acres of land close to the area he was born. This allowed him to get the quantity of milk that was needed to produce good quality milk chocolate, which during this period was exclusively a Swiss product. He eventually managed to make a good formula for it using the method of trial and error, and in 1903 the building of his chocolate manufacturing plant started. The factory was completed in 1905, and later became the biggest chocolate manufacturing plant in the world. It used the most up to date mass production methods available which led to Hershey's chocolate becoming the first product like it to be nationally marketed.

The factory started off in the middle of farmland, but eventually buildings such as houses, churches and other factories and businesses were set up around the chocolate factory, along with a transportation system. Eventually a public school system was implemented along with HersheyPark which had amusement arcades and a swimming pool. This bought more business to the town. Hershey used a lot of the money he had to help others and he and his wife were unable to have children. All of the money he made from his chocolate business he put into the public school (later renamed the Milton Hershey School) via a trust. He also set up the charitable M.S Hershey Foundation.

Source: This profile is written from the authors based on information in: Biography.com (2016) and Hershey Website (2014)

7.1 Introduction

One of the most difficult aspects of starting and growing a new venture is obtaining the necessary resources at the time needed. In addition to supply resources, distribution channel resources, and human resources, there are capital resources needed which particularly at the start of the new venture are difficult to obtain. This chapter will focus on raising capital by first discussing the types of capital and them the various sources of capital and their aspects. The chapter concludes with a discussion of the capital raising process and the stages in financing.[1]

[1]This chapter is based on Hisrich, Peters, and Shepherd (2017). *Entrepreneurship*, 10th Edition, McGraw-Hill Education, New York. An expanded discussion and detailed references can be found there!

7.2 Types of Capital

There are basically two forms of capital—debt & equity. Each type of capital has its advantages and disadvantages. ***Debt financing*** usually only involves the venture receiving capital without any additional contributions. ***Equity financing*** involves receiving the capital as well as external advice, mentorship, contracts, marketing assistance, and sources supply depending on the source of the capital. Debt financing occurs when capital is received by the venture in exchange for regular payments of interest and reduction in the amount of capital borrowed. Aspects of debt financing will be discussed below and equity financing in the next sections of this chapter.

Effective entrepreneurial management requires keeping a balance between debt and equity financing. The more debt the venture has the more highly it is leveraged which increases the risks involved in financing or doing any business activities with the venture. It is important to remember that as the risks increase the cost of any form of capital also increase.

Debt capital can take many forms and can have the interest portion be at a variable or fixed rate. Debt capital can be secured or unsecured and can or cannot be convertible into equity as well as have warrants for common stock included. As these factors indicate, debt is a very flexible form of capital that every entrepreneur should consider particularly if the interest rates are low and the other costs of convertibility and/or warrants are minimal. Debt capital is usually faster to obtain and cheaper than equity capital. While the cost of debt capital is easily determined, it also provides some tax benefits in many countries such as United States. In the U. S., the interest cost can be deducted affecting the taxable income and taxes paid.

A majority of small business, particularly at start up, use *consumer credit* to help provide financing. This is often in the form of personal or business credit cards. Not only does this provide a convenient and fast method for purchasing goods and services, it also provides a method for tracking expenses. Credit cards can also provide a very expensive means for borrowing if balances are carried forward from month to month. The fees, rewards, costs vary by card such as American Express, Visa, or Master card, making it important to evaluate each of the options available.

The biggest and most frequently used source of capital are banks. *Banks* primary business is to provide loans to businesses and individuals. The aspects of bank lending decisions and the types of bank loans are indicated in Table 7.1. To receive a bank loan, the entrepreneur should first select a bank that has done successful business in the industry of the venture previously. This familiarity with the industry will help in securing the loan in a timely fashion. The bank selected should also have experience in providing government guaranteed loans if needed. Most governments offer loan guarantee programs so that a business in that country can obtain money even when the bank has determined that it is not credit worthy. The Small Business Administration of the United States provides this guarantee which varies by industry, location, and amount of loan requested.

Bank lending decisions usually involve accessing five aspects: character, capacity, capital, collateral, and conditions. Character refers to the assessment and history of the individual requesting the loan. Capacity refers to the bank's assessment of the

Table 7.1 Bank lending decisions and types of bank loans

Bank lending decisions
• Character
• Capacity
• Capital
• Collateral
• Conditions
Types of bank loans
• Account receivable loans
• Equipment loans
• Inventory loans
• Real estate loans
• Installment loans

ability of the venture to pay back the loan based on its potential sales and earnings. Capital is the amount of the loan request. Collateral is the amount and the type of asset being pledged as the basis of loan; banks are asset based lenders which means the venture, individual, or an outside third party must have an asset equal to or greater than the value of the loan which can be liquidated if the terms of the loan are not fulfilled. Conditions refer to the type of interest, interest rate, and any business ratios that must be adhered to while the loan is in place.

There are many *types of loans* indicated in Table 7.1 such as account receivable loans, equipment loans, inventory loans, real-estate loans, and installment loans. The loans most frequently used particularly in growing a business are accounts receivable loans. In this type of loan, a bank lends the business money in exchange for the invoice for the goods or services provided to a customer. The better the credit rating of the customer, the easier it is to obtain the loan and the lower the interest rate. When the bank actually collects the money from the sale this is even more effective entrepreneurial management and is called factoring accounts receivable. A bank, given it is collecting from a credit worthy customer will loan up to 80% of the value of the invoice.

7.3 Sources of Capital

There are many sources of finances that are indicated in Table 7.2. To be an effective entrepreneurial manager each resources needs to be evaluated on the basis of: the length of time of the capital; the cost of the capital; and any control aspects of the capital in terms of ownership or covenants such as financial ratios that need to be kept or membership in the Board of Advisors/Directors. Each potential source of capital should be compared to the ideal capital which is that the capital can be used forever (length of time), has no cost (cost) and has no covenants or ownership issues (control). This allows comparisons to be made and trade-offs considered; perhaps it is better for example to take a higher interest rate and if the capital can be used for a longer length of time.

Table 7.2 Sources of financing

	Length of time		Cost				Control	
Sources of financing	Short-term	Long-term	Fixed rate debt	Floating rate dept	Percent of profits	Equity	Convenants	Voting rights
Self								
Family and friends								
Crowdfunding								
Supplier and trade credit								
Commercial banks								
Angels (private investors)								
Venture capital								
Private equity placements								
Private equity offerings								
Private equity funds								
Government programs								

7.3.1 Self

The first source of capital is self. In order to raise any equity capital from most any other source the entrepreneur (self) needs to have money invested (often called blood equity) as well as all the work on the idea and the venture to date (often called sweat equity). Often, the entrepreneur is the only source of financing which is called bootstrapping—a process through which the entrepreneur finds creative ways to explore opportunities to launch the business venture. ***Bootstrapping*** usually involves using the cash flow and credit of the venture; some and more frequently used are: the personal resources of the entrepreneur; the resources of the family and friends of the entrepreneur; barter and pay on performance; as well as stock options or bonus for employees and any resource provider. Any source that can provide the necessary capital to launch and grow the venture is considered. One option that the entrepreneur should consider is keeping their present job and starting and growing the business on a part time basis until the business can more easily support the salary and fringe benefit costs. This allows an entrepreneur to have a source of income while building and growing their venture. This takes some financial pressure off the entrepreneur and the venture.

Similarly, any employees needed should be hired in the beginning on a contract basis to help reduce the costs while determining the capabilities of the employees and the needs of the venture. As few people as possible should be employed as provider of capital do not like to pay for overhead and salaries particularly before the venture positively cash flows which means these costs can be supported by the revenue stream of the venture not externally raised capital. A company in the fast growing security industry until a technology involving identifying left items immediately in any environment had a most difficult time securing funding in part because capital providers were asked to fund the salaries of five individuals for about three years before the venture could positively cash flow and pay the salaries from revenue obtained.

The key is instead of purchasing something new is to purchase used equipment and furniture, rent or lease with the option to buy or outsource. It is surprising how many things can be outsourced cost effectively reducing capital needs and freeing up existing capital for other users. Production, packaging, shipping, delivery and even accounting are usually the areas for successful outsourcing.

7.3.2 Family and Friends

Besides self, the next source of capital frequently used is ***family and friends***. Great care must be taken in securing capital from family and friends to avoid any future friction or ill will. A family/friend in the role of investment should be treated like any investor receiving information regularly (such as unaudited incomes statements quarterly) and a complete set of financials (Income Statement, Cash Flow Statement, and Balance Sheet) at the end of each year. One author has the rule that when in family/friends relationship treat the individual as such bust also treat the individual differently as an investor.

7.3.3 Crowdfunding

Crowdfunding is relatively new way for an entrepreneur to raise financial resources. Started in the United Kingdom, this method in attaining capital rapidly spread throughout the United States and the world. Today there are numerous crowdfunding platforms. Internet-based market places that connect those seeking funds with millions of individuals most of them with small amounts of capital. These crowdfunding platforms (websites) such as Indiegogo and Kickstarter drastically lower the costs of raising capital by leveraging the geographical and social reach of the internet to connect fund raisers with millions of potential fund providers. In exchange, each platform charges those receiving funds a small fee, typically in the form of a percent of the capital earned.

There are basically four ***types of crowdfunding*** models: equity, debt, rewards, and charity. Equity based crowdfunding websites such as AngelList and CircleUp have platforms which actually sell shares of the company raising capital. Only a small fraction of the funds raised to date through crowdfunding have been in exchange for equity in the United States. This should rapidly increase once the final legal and government approvals occur. Crowdfunding debt which sometimes is called peer to peer lending is one of part of a larger group of “Fin Tech” internet software. While banks are the primary providers of debt financing through various types of loans, debt crowd funding provides a way for people to lend money directly to those who need it. While this should provide revenue to the lenders and cost savings to the entrepreneurs/ventures, the platform providing this matching service often does not involve crowdfunding activities (placing the debt opportunity to the masses). With charity crowdfunding platforms, there is nothing received by the equity providers but a feeling of doing good and giving back which in and of itself is a great return. Two charitable crowdfunding platforms, Causes and Crowdrise, always provide information about how the money (donation) has and will be used and the results achieved.

The crowdfunding sites offering rewards are very creative and show significant innovation. Legally, these sites are looked at in the same way of charity crowdfunding sites as no equity or money is received in exchange for the money provided by the crowd funder. Crowdfunding receive the promise of something in return for providing the funding but they may receive nothing and have no recourse when this is the case. Probably the best known crowdfunding site offering rewards is Kickstarter which has been used to fund the development and production of products such as 3D printers and smartwatches, services, music albums, and even films. One bright CPA/MBA wanted to raise money to produce a documentary film and the crowd funders were rewarded by having their names listed in the credits. The size of the print of the name varied by the amount of the money provided.

Some of the greatest success stories in crowdfunding include the: Oculus Rift, Exploding Kitten, Back to Mars, and Musician's Relief.

Oculus Rift: This wearable virtual-reality gaming headset funded by crowdfunding offers beautiful high-resolution 3D experience.
Exploding Kittens*:* Exploding Kittens is a card game that obtained more than the $10,000 asked for in just 20 min on the Kickstarter website.
Back to Mars*:* Over 91,000 fans provided funding to bring back this once cancelled mystery TV series—Veronica Mars—for a feature film.
Musician' Relief*:* Over 66,000 was raised through crowdfunding to provide care for the diagnosed kidney cancer of musician John Jennings.

7.3.4 Supplier and Trade Credit

Often overlooked as sources of financing venture are *entities* the venture is doing business with. These include supply companies and distributing companies. If the supplying company would extend the time payment is due from at the time of order, time of receipt, or 30 days to a longer period of time, this would allow the venture extra time to use the payment money for other uses. Similarly, if the distributors could pay the venture more quickly than their usual 30, 60, or 90 days, this shorter payment time provides money more quickly and reduces the size of the accounts receivable of the company. Whole Foods encourages new start-up ventures by carrying their products and most often paying within 30 days.

7.3.5 Angels (Private Investors)

Angel investors investing individually or in groups provide a significant amount of capital at the start up and early growth stage. Angel Investors are usually well educated, many having graduate degrees, and will finance from all over the world but prefer financing from within one days' travel. These investors like to play a more active role in the venture and can be particularly helpful in providing access to individuals who could be helpful to the venture. One small firm was trying unsuccessfully to contact a professor in a highly ranked university. This was facilitated and the contact made within a few days after the angel investor contacted the dean of the professor at the university. The average angel investment is around $320,000 but it can vary from $20,000–$1,000,000 depending upon the factors of the deal.

Frequently, angels will join with other angels, usually from a common circle of friends, to finance larger deals. Is there a preference for the type of ventures in which they invest? While angels invest in every type of investment opportunity, from small retail stores to large oil exploration operations, some prefer manufacturing of both industrial and consumer products, energy, service, and the retail/wholesale trade, they will only invest in a few industries they totally understand. The returns expected decrease as the number of years the firm has been in business increases.

Angel investors can be more patient in their investment horizons and can wait for *a period of 7 to 10 years* before cashing out. This is in contrast to the more predominant five-year time horizon in the formal venture-capital industry. Investment opportunities are rejected when there is an inadequate risk/return ratio, a subpar management team, a lack of interest in the business area, or insufficient commitment to the venture from the principals.

The angel investor market averages about $20 billion each year, which is about the same level of yearly investment of the venture-capital industry. The angel investment is in smaller amounts in about eight times the number of companies. In normal economic conditions, the number of active investors is over 250,000 individuals in the United States, with several investors typically being involved in an investment.

Where do these angel investors generally find their deals? Deals are found through referrals by business associates, friends, active personal research, investment bankers, and business brokers. However, even though these referral sources provide some deals, most angel investors are not satisfied with the number and type of investment referrals. Many investors are either partially or totally dissatisfied with their referral systems and feel that at least moderate improvement is needed.

A phenomenon that is spreading rapidly throughout the United States and the world, particularly Austria, Germany, Ireland, and the United Kingdom, is groups of angels—organized ***angel investor groups***. Each angel group or club usually has a meeting for about 2 to 3 h about 6–10 times each year. Some groups co-invest with other groups. The group as a whole does not have any money but serves as a convening and screening device for the presentations. The individual members of the group make the investment either individually or with others interested if any investment is made.

The typical club or network process is that you send the required form to the designated club member. Following initial screening, if the entrepreneur is chosen, then follow-up meetings with several club members occur. If the entrepreneur is selected to present at a future meeting, then the entrepreneur is provided guidance in terms of business plan refinement and the presentation. Usually 12–30 min is allocated for a presentation and questions, and then any interested club members meet with the entrepreneur to discuss further steps in the investment decision process. The approximately 300 organized angel investor groups are identified by the Kauffman Foundation (www.kauffman.org). Most, such as the Thunderbird Angel Network (TAN), can be accessed through a standardized software program.

Each angel group has a somewhat different format and meeting times. For example, TAN meets five times each year and looks at three to four deals per meeting, screened from 75 to 100 applicants. Each invited firm has 12 minutes to present their idea, market, financials, and management team followed by a 10-minute question-and-answer period and then by a 5-minute initial due diligence done by Thunderbird School of Global Management students. Those ventures of interest by the investors and the group interested then receive further evaluation (due diligence) to determine the investment potential and valuation. The hosting group itself has no investment money and charges a small annual fee for hosting the meeting and securing the possible investment deals.

When the private individual investors put money into a fund, which usually has a man-ager, this becomes an ***angel fund***. An angel fund operates much like a small venture capital fund except the private investors or their designated representatives make the investment decisions. Since most private investors prefer to invest on a deal-by-deal basis without this upfront commitment as occurs in angel groups or networks, there are very few angel funds operational.

When an entrepreneur is very successful in previous callouts of ventures, he or she often establishes a family office to manage their affairs and assets particularly upon passing. A portion of the finances of the family office are allocated to financing early and later stage ventures in addition to real estate, stocks and bonds.

7.3.6 Venture Capital

The next source of financing—venture capital—will be discussed in terms of its nature, the venture-capital industry in the United States, and the venture-capital process.

7.3.6.1 Nature of Venture Capital

Venture capital is another misunderstood area in enterprise financing. It is best to view venture capital broadly as a professionally managed pool of equity capital. Frequently, the ***equity pool*** is formed from the resources of wealthy individuals or institutions who are limited partners. Other principal investors in venture-capital limited partnerships are pension funds, endowment funds, and foreign investors. The pool is managed by a general partner—that is, the venture-capital firm—in exchange for a percentage of the gain realized on the investment and a fee. The investments are usually in second and third stage deals and leveraged buyouts. In fact, venture capital can best be characterized as a long-term investment usually occurring over a 5-to-7-year period. In each investment, the venture capitalist takes an equity participation through stock, warrants, and/or convertible securities and has an active involvement in the monitoring of each portfolio company, bringing investment, financing planning, and business skills to the firm. The venture capitalist will often provide debt along with equity in the financing.

7.3.6.2 Overview of the Venture Capital Industry

Although the role of venture capital was instrumental throughout the industrialization of the United States, the first step toward institutionalizing the venture-capital industry took place in 1946 with the formation of the American Research and Development Corporation (ARD) in Boston. The ARD was a small pool of capital from individuals and institutions put together by General Georges Doriot to make active investments in selected emerging businesses.

The next major development, the Small Business Investment Act of 1958, married private capital with government funds to be used by professionally managed small-business investment companies (SBIC firms) to infuse capital into start-ups and growing small businesses. With tax advantages, government funds for leverage, and status as a private-capital company, SBICs were the start of the now formal venture-capital industry. The 1960s saw a significant expansion of SBICs with the approval of approximately 585 SBIC licenses that involved more than $205 million in private capital. Many of these early SBICs failed due to inexperienced portfolio managers, unreasonable expectations, a focus on short-term profitability, and an excess of government regulations. These early failures caused the SBIC program to be restructured. There are approximately 360 SBICs operating today, of which 130 are minority enterprise small-business investment companies (MESBICs) funding minority enterprises.

During the late 1960s, small private venture-capital firms emerged. These were usually formed as limited partnerships, with the venture-capital company acting as the general partner that received a management fee and a percentage of the profits earned on a deal. The limited partners, who supplied the funding, were frequently institutional investors such as insurance companies, endowment funds, bank trust departments, pension funds, and wealthy individuals and families. There are over 900 of this type of venture-capital establishment in the United States.

Another type of venture-capital firms is the venture-capital division of major corporations. These firms are sometimes associated with banks and insurance companies, although companies such as 3M, Monsanto, Xerox, Intel, and Unilever house such firms as well. Corporate venture-capital firms are more prone to invest in windows on technology or new market acquisitions than are private venture-capital firms or SBICs. Some of these corporate venture-capital firms have not had strong results.

In response to the need for economic development, a fourth type of venture-capital firm has emerged in the form of the geographically oriented venture-capital fund. These funds have a variety of formats. While the size and investment focus and industry orientation vary from state to state, each fund typically is required to invest a certain percentage of its capital in the particular state. Generally, the funds that are professionally managed by the private sector, outside the state's bureaucracy and political processes, have performed better.

An overview of the types of venture-capital firms is indicated in Fig. 7.1. Besides the four types previously discussed, there are now emerging university-sponsored venture-capital funds, as well as philanthropic venture funds. The university sponsored funds, usually managed as separate entities, invest in the technology of the particular university. At such schools as Stanford, Columbia, and MIT, students assist professors and other students in creating business plans for funding as well as assisting the fund manager in his or her due diligence, thereby learning more about the venture-funding process.

The venture-capital industry has not returned to the highest level of dollars invested in 1999 and 2000. While the total amount of venture-capital dollars invested increased steadily from $7.8 billion in 1995 to a high of $104.7 billion

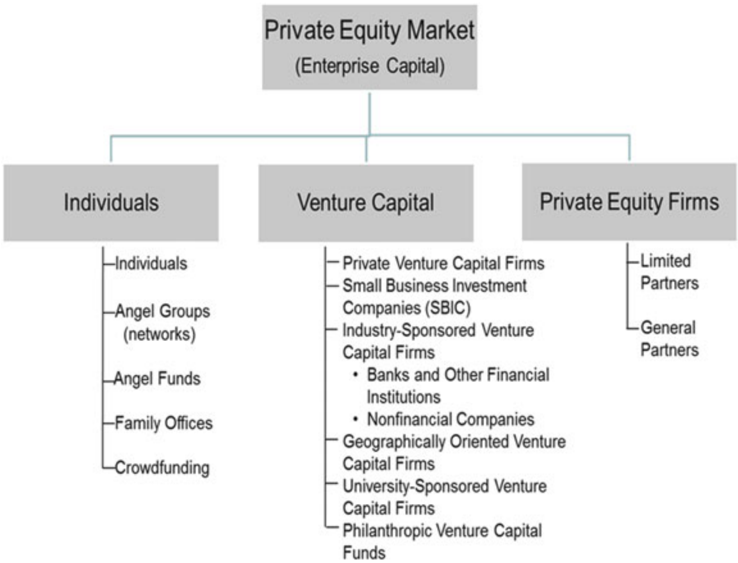

Fig. 7.1 Enterprise capital market

in 2000, the total dollars invested declined to $40.7 billion in 2001, $21.7 billion in 2002, and $19.6 billion in 2003. There was a slight increase to $21.6 billion in 2004 and $21.7 billion in 2005. The total amount invested increased again in 2006 ($26.7 billion) and 2007 ($30.9 billion) before declining with the economic downturn to $28.3 billion in 2008 and $19.7 billion in 2009. It has increased to $27.5 billion in 2012, $29.9 billion in 2013, and $48.3 billion in 2014.

The total amount of venture-capital dollars invested, disseminated across the number of deals. Then number of venture-capital deals went from 1773 in 1995 to a high of 7809 in 2000. In 2003, 2004, and 2005, the number of deals stayed fairly steady, at 2865, 2966, and 2939, respectively. The number of deals increased in 2006 (3675) and again in 2007 (3952) before declining in 2008 to 3808 deals and in 2009 to 3056 deals. The number of deals increased to 3496 in 2010 and 3673 in 2011. The deals have steadily increased since then—3936 (2012), 4193 (2013), and 4356 (2014).

These deals concentrated in three primary areas: software (39%), biotechnology (14%), and media and entertainment (10%). This investment has significantly impacted the growth and development of these three industry sectors. Other industry areas receiving venture-capital investment include the following: computers and peripherals (7%), IT services (6%), medical devices and equipment (5%), and industrial energy (4%).

The largest amount of money raised was for later-stage (41%) and then expansion-stage investments (33%), followed by start-up/seed stage (25%) and early stage (1%). Traditionally, the largest amount of money raised is for expansion-stage investment.

The amount of money invested in 2014 ($48.3 billion) by region of the country indicates that the areas receiving the largest amount of venture capital were the Silicon Valley—$6.2 billion (43%) and New England—$2.0 billion (14%). Other areas receiving funding were metro New York—$1.1 billion (18%); LA/Orange County—$1.0 billion (7%); and the Southeast—$1.0 billion (6%).

7.3.6.3 Venture Capital Process

To be in a position to secure the funds needed, an entrepreneur must understand the philosophy and objectives of a venture-capital firm, as well as the venture-capital process. The objective of a venture-capital firm is to generate long-term capital appreciation through debt and equity investments. To achieve this objective, the venture capitalist is willing to make any changes or modifications necessary in the business investment. Since the objective of the entrepreneur is the survival of the business, the objectives of the two are frequently at odds, particularly when problems occur such as the numbers not being met.

Since there is more risk involved in financing a business earlier in its development, more return is expected from early-stage financing than from acquisitions or leveraged buyouts, which are later stages of development. The significant risk involved and the pressure that venture-capital firms feel from their investors (limited partners) to make safer investments with higher rates of return have caused these firms to invest even greater amounts of their funds in later stages of financing. In these late-stage investments, there are lower risks, faster returns, less managerial assistance needed, and fewer deals to be evaluated. The venture capitalist does not necessarily seek control of a company and actually would prefer to have the firm and the entrepreneur at the most risk and in control. The venture capitalist will require at least one seat on the board of directors. Once the decision to invest is made, the venture capitalist will do anything necessary to support the management team so that the business and the investment prosper. The management team is expected to direct and run the daily operations of the company. A venture capitalist supports the management team with investment dollars, financial skills, planning, and expertise in any area needed.

Since the venture capitalist provides long-term investment (typically 5–7 years), it is important that there be mutual trust and understanding with the entrepreneur. There should be no surprises in the firm's performance. Both good and bad news needs to be shared, with the objective of taking the necessary action to allow the company to grow and develop in the long run. The venture capitalist should be available to the entrepreneur to discuss problems and develop strategic plans.

A venture capitalist expects a company to satisfy three general ***criteria*** before he or she will commit to the venture. First, the company needs to have *a strong management team* composed of individuals with solid experience and backgrounds, a strong commitment to the company, capabilities in their specific areas of expertise, the ability to meet challenges, and the flexibility to scramble wherever necessary. A venture capitalist would rather invest in a first-rate management team and a second-rate product than the reverse. The management team's commitment needs to be reflected in dollars invested in the company. The amount varies by country while the amount of the investment is important, more telling is the size of this investment relative to the management team's ability to invest. The commitment of the management team should be backed by the support of the family, particularly the spouse, of each key team player. A positive family environment and spousal support allow the entrepreneur and team members to spend the 60–70 h per week necessary to start and grow the company. One successful venture capitalist makes it a point to have dinner with the entrepreneur and spouse, and even to visit the entrepreneur's home, before making an investment decision. According to the venture capitalist, "I find it difficult to believe an entrepreneur can successfully run and manage a business and put in the necessary time when the home environment is out of control."

The second criterion is that the *product and/or market opportunity* must be unique, having a differential advantage or three to five unique selling propositions in a growing market. Securing a unique market niche is essential since the product or service must be able to compete and grow during the investment period. This uniqueness needs to be care-fully spelled out in the marketing portion of the business plan and is even better when it is protected by a patent or a trade secret.

The final criterion for investment is that the business opportunity must have *significant capital appreciation*. The exact amount of capital appreciation varies, depending on such factors as the size of the deal, the stage of development of the company, the upside potential, the downside risks, and the available exits. The venture capitalist typically expects a significant percent return on investment in most investment situations.

The venture-capital process that implements these criteria is both an art and a science. The element of art is illustrated in the venture capitalist's intuition, gut feeling, and creative thinking that guide the process. The process is scientific due to the systematic approach and data-gathering techniques involved in the assessment.

The process starts with the venture-capital firm establishing its philosophy and investment objectives. The firm must decide on the following: the composition of its portfolio mix (including the number of start-ups, expansion companies, and management buyouts); the types of industries; the geographic region for investment; and any product or industry specializations.

The venture-capital process can be broken down into four primary stages: preliminary screening, agreement on principal terms, due diligence, and final approval. The ***preliminary screening*** begins with the receipt of a good business plan. Most venture capitalists will not even talk to an entrepreneur who doesn't have one. The venture capitalist then determines if the proposal fits his or her long-term policy and short-term needs in developing a portfolio balance. In this preliminary screening, the venture capitalist investigates the economy of the industry and evaluates whether he or she has the appropriate knowledge and ability to invest in that industry. The numbers are reviewed to determine whether the business can reasonably deliver the ROI required. In addition, the credentials and capability of the management team are evaluated to determine if they can carry out the plan presented.

The second stage is the ***agreement on general terms*** between the entrepreneur and the venture capitalist. The venture capitalist wants a basic understanding of the principal terms of the deal at this stage of the process before making the major commitment of time and effort involved in the formal due diligence process.

The third stage, ***detailed review and due diligence***, is the longest stage, involving between one to three months. This includes a detailed review of the company's history, the business plan, the resumes of the individuals, their financial history, and target market customers. The upside potential and downside risks are assessed; there is a thorough evaluation of the markets, industry, finances, suppliers, customers, and management.

In the last stage, ***final approval***, a comprehensive, internal investment memorandum is prepared. This document reviews the venture capitalist's findings and details the investment terms and conditions of the investment transaction. This information is used to prepare the formal legal documents that both the entrepreneur and venture capitalist will sign to finalize the deal.[2]

7.3.6.4 Locating Venture Capitalists

One of the most important decisions for the entrepreneur lies in selecting the venture-capital firm to approach. Since venture capitalists tend to specialize both geographically and by industry (manufacturing industrial products or consumer products, high technology, or service) and by size and stage of investment, the entrepreneur should approach only those venture capitalists that may have an interest in their investment opportunity based on these criteria.

Most venture capital firms belong to the National Venture Capital Association and are listed on its Web site (www.nvca.org). An entrepreneur should carefully research the names and addresses of prospective Venture-capital firms that might have an interest in their particular investment opportunity. There are also regional and national venture-capital associations. For a nominal fee or none at all, these associations will frequently e-mail the entrepreneur a directory of their members, the types of businesses their members invest in, and any investment restrictions. Whenever possible, the entrepreneur should be introduced to the venture capitalist. Bankers, accountants, lawyers, and professors are good sources for these introductions.

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[2] A discussion of some of the important sectors in this decision process can be found in Fried, Elonso, and Hisrich (1995). How Venture Capital Firms Differ, Journal of Business Venturing, Vol. 10, No. 2, pp. 157–79; Hisrich and Fried (1994). Towards a Model of Venture Capital Investment Decision-Making, Financial Management, Vol. 23, No. 3, pp. 28–37; Hisrich, Petkovic, Ramadani, and Dana (2016). Venture capital funds in transition countries: Insights from Bosnia and Herzegovina and Macedonia, *Journal of Small Business and Enterprise Development*, Vol. 23, No. 2, pp. 296–315; MacMillan, Zemann, and Narasimba (1987). Criteria Distinguishing Successful from Unsuccessful Ventures in the Venture Screening Process, *Journal of Business Venturing,* Vol. 2, No. 1, pp. 123–138.

7.3.7 Private Equity Placements and Share Offerings

One of the sources of capital that is not frequently used as venture capital or private individual investors is a ***private placement offering***. This rule allows a company to raise capital that is not publicly traded but allows shares to be purchased often by accredited investors depending on the nature and registration of the offering. When trading on a smaller exchange, the company can allow its stock price to be traded on “80 dollars” which means there is no public disclosure of the stock price.

If a private placement is issued without an exchange, the biggest problem is the valuation of the equity ownership (stock) if an owner wants to sell. Ratios of revenue/assets to price per share in part exchange can assist in the valuation. Ease of exchange and valuation is one of the advantages of being publicly traded, especially on a recognized stock exchange such as the New York Stock Exchange, the London Stock Exchange, the Frankfurt Stock Exchange, or NASDAQ.

7.3.8 Government Grant Programs

Government Grant Programs are a source of capital that are important for effective entrepreneurial management. Most developed and many developing economies have grants for entrepreneurs and SME’s that do not have to be paid back. These grants are for various purposes but the majority are for the venture to locate in a specified geographical area. These grants can be on a national, regional (state) or city geographic level. For example, the Unites State have grants at all levels. Germany has regional grants for ventures to locate in a specific area of Germany that needs economic development (regional). Austria has grants for ventures to locate in the city of Vienna. Since the grant money received does not have to paid back this is the most inexpensive source of capital for any venture that can meet the criteria of the grant award.

7.4 Summary

For effective entrepreneurial management in financing a business, the entrepreneur needs to carefully determine the amount and timing of funds needed. Seed or start-up capital is the most difficult to obtain, with the most likely source being the private equity market. This often is angels or private investors, who are wealthy individuals, average one or two deals per year, ranging from $100,000 to $500,000, and generally find their deals through referrals.

Although venture capital may be used in the first stage, it is primarily used in the second or third stage to provide working capital for growth or expansion. Venture capital is broadly defined as a professionally managed pool of equity capital.

To achieve the venture capitalist’s primary goal of generating long-term capital appreciation through investments in business, three criteria are used: The company must have strong management; the product/market opportunity must be unique; and the capital appreciation must be significant, offering a significant return on investment. The process of obtaining venture capital includes a preliminary screening, agreement on principal terms, due diligence, and final approval. Entrepreneurs need to approach potential venture capitalists with a professional business plan and a good concise presentation. Valuing the company is a concern of the entrepreneur. Eight factors can be used as a basis for valuation: the nature and history of the business, the economic outlook, book value, future earnings, dividend-paying capacity, intangible assets, sales of stock, and the market price of stocks of similar companies. Numerous valuation approaches that can be used were discussed.

The entrepreneur and investor need to agree on the terms of the transaction, known as the deal. When care is taken in structuring the deal, the entrepreneur and the investor will maintain a good relationship while achieving their goals through the growth and profitability of the business.

Case Study: Eric Colin's Needs for Funding

Eric Colin has learned that his employer, a regional chemical manufacturer and distributor, had been sold and he will soon be unemployed. Colin, a young business professional, had been the Director of Sales for the distribution division of Superior Chemical. As a result of his chemical distribution business experience, he is considering beginning a chemical distribution business. Superior has a solid understanding of the chemical industry and the distribution process but his knowledge of accounting and finance is limited. He has completed a preliminary investigation into a number of business startup issues but is not sure how to put everything together.

The Situation

At this point, the required startup capital is only a very rough estimate but he believes a minimum equity investment of $500,000, and maybe as much as a $1,000,000, will be required. The proceeds from the sale of his Superior holdings (stock and stock options), severance pay and family savings could be used to start the new business. Colin and his wife have sufficient other funds to cover living expenses for nine months. Colin's father may be another source of startup equity capital.

Colin's Experience

Colin has a solid understanding of the chemical distribution process. While at Superior, he had Profit & Loss responsibility but he is uncomfortable analyzing and interpreting financial results. He has very limited balance sheet responsibility. Colin had completed a preliminary site location investigation and examined other startup issues but is not sure how to put everything together. Colin has discussed his situation with a friend who is a commercial lending officer with a large local bank. He suggested Colin visit the Small Business Development Center (SBDC) at the University of Missouri—Kansas City. His friend thinks the Small Business Development Center

(continued)

could provide the assistance Colin needs to determine if his new business is feasible.

New Venture Financing

Based on Colin's initial (very rough) projections, there is sufficient capital to begin operations but with little (if any) margin for error.

Small Business Development Centers

The U.S. Small Business Administration administers the Small Business Development Center Program to provide management assistance to current and prospective small business owners.

The Meeting

Colin arranged a meeting with Joe Blake, the Director of the Small Business Development Center at the University of Missouri—Kansas City, to determine what assistance, if any, the SBDC could provide in beginning his new venture. Before becoming the Director of the SBDC, Blake owned and operated a number of small businesses as well as worked as a commercial loan officer for a commercial bank. Blake explained the services available and asked Colin to describe his proposed new business. Blake described the chemical industry and the role of a distributor. He would begin operations in Kansas City from a leased warehouse/office building located in an industrial park. The facility would be leased for five years at an annual cost of $90,000 and includes two, five-year renewal options. The facility would need to be modified to handle both liquid and dry chemical repacking operations, as well as storage tanks for bulk liquids. Exact numbers have not been developed but he thinks the modifications would cost approximately $400,000. With the modifications and six employees, Williams estimates the facility would support an annual sales volume between four and six million dollars. First-year sales dollars are estimated to approach five million, with his existing customer contacts providing the majority of the sales. Initial inventory would require an investment of $600,000. Colin expects to offer credit terms of net 30, the industry average. Colin is very confident the estimated first year sales can be achieved and can be doubled in the second year of operation. According to RMA Annual Statement Studies, distributors report a "Sales/Total Asset" ratio between 2 and 4.

In addition to questions regarding financing requirements for the new venture, Blake asked Colin what form of business organization he intended to select. Colin indicated he hadn't really given it much thought and didn't know much about any organization form other than the corporation.

Given the industry experience of Colin, Blake thinks the proposed new business venture has merit, but told Colin he needs to convert his ideas and thoughts to a business plan. A formal business plan would provide Colin with a guide to starting the business. Colin has been involved in preparing three-year plans and annual budgets but has had no experience in preparing a

(continued)

business plan. Colin admitted he doesn't even really know what a business plan includes. Blake suggested that one of the SBDCs counselors could provide help in preparing the plan. Blake said the plan would also help quantify the assets and financing needed to start the business. Colin agreed to work with a counselor to develop a plan before a final decision to begin the business is made.

Assignments

1. Discuss the importance of business plan to acquire external financing!
2. Put yourself in Colin's shoes and analyze the different funding methods available in this scenario!

Source: This profile is written and adapted from the authors based on information in Kunz and Dow (2015)

Questions for Discussion

- What is the cheapest source of funds? When all other sources turn down your request for funding, what source is most likely to say yes? Why is this the case? Is the entrepreneur exploiting a personal relationship with this potential source of capital? What are the consequences of using this source of capital if the business goes bankrupt?
- Should the government provide grants for entrepreneurs starting new businesses? Should the government guarantee loans for small businesses that are missing the necessary track record, assets, or other ingredients to obtain a commercial bank loan?

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Entrepreneurial Businesses Growth 8

Learning Objectives
After reading this chapter, you should be able to:

- Understand factors that influence the growth.
- Know the different perspectives and dimensions of growth
- Know the main characteristics of fast-growing companies
- Understand the management actions that enable growth
- Describe the major growth strategies
- Explain the exit options from a company

Profile: Grace Ayaa—Grace's Peanut Butter

Grace Ayaa is a mother of four who lives in Kulambiro, Uganda. She is of the Acholi tribe and lived in the Northern districts of Kitgum before the civil war forced her to leave her home. She cares for 13 children, 7 of whom are not her own but orphans of the civil war, and now adopted into her family.

Grace tried to support herself and her family making peanut butter using a mortar and pestle. The process was so slow, and batch of produce so small, that it was very difficult to make the peanut butter fast enough to earn enough money to cover living costs for her and her family.

Grace knew she had to change her processes for her business to be successful, so she saved enough money to purchase a processing machine, no longer grinding with a mortar and pestle. With her new investment she was able to make much larger batches of peanut butter more quickly than before, but she had no way of storing her peanut butter and therefore could not make more until her current batch had sold.

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R.D. Hisrich, V. Ramadani, *Effective Entrepreneurial Management*, Springer Texts in Business and Economics, DOI 10.1007/978-3-319-50467-4_8

Grace took a loan of $475 through Kiva, administered by Life in Africa, a Kiva Field Partner. Grace intended to spend 50% of her loan to purchase a refrigerator to store the larger batches of peanut butter, 25% on packing materials and an additional 25% as working capital for her business.

Within 6 months Grace had employed an additional person to help her with her business. She was also able to save enough money with her increased profits to acquire a small piece of land, so that she could better care for her children who were growing up quickly.

Grace has become an example in her community of a successful woman, despite the difficulties she has faced. Grace is no longer forced to decide which children she can send to school each semester as she can afford to send them all, and she is now building a home for her family on the land she was able to purchase.

Source: KIVA entrepreneur profiles (https://pages.kiva.org/press/entrepreneurs#grace). Published with kind permission from KIVA.

8.1 Introduction

This chapter focuses on the most important aspect of growing the entrepreneurial businesses by first looking at identifying the main factors that influence the growth followed by the discussion of the main perspectives of growth. Characteristics of fast-growing companies and management actions enabling growth are then discussed along with four major growth strategies—market penetration, market development, product development and diversification. The chapter concludes with a presentation of some exit options from a company.

8.2 Growth Perpsectives and Growth Cycle

One of the peculiarities of entrepreneurial businesses is the huge potential for growth. Entrepreneurial businesses usually start as small ventures—but with a tendency to become very large. Such is the story of Bill Gates (Microsoft), Steve Jobs (Apple), Michael Dell (Dell Inc.), etc. The motives why entrepreneurs aim to grow their businesses are different, as creating more wealth, the need for achievement, the desire to make a difference in the world, etc. Growth and successful development of a business depends on several factors. As most important are considered luck, entrepreneur, culture, strategy and company, as indicated in Fig. 8.1.

Growth is defined as an increase of sales, profits, number of employees, market share, penetration into new markets, etc. Here should be noted that there is a difference between the words 'growth', and 'expansion', which very often, in daily conversations are used interchangeable. *Growth* is the first significant increase

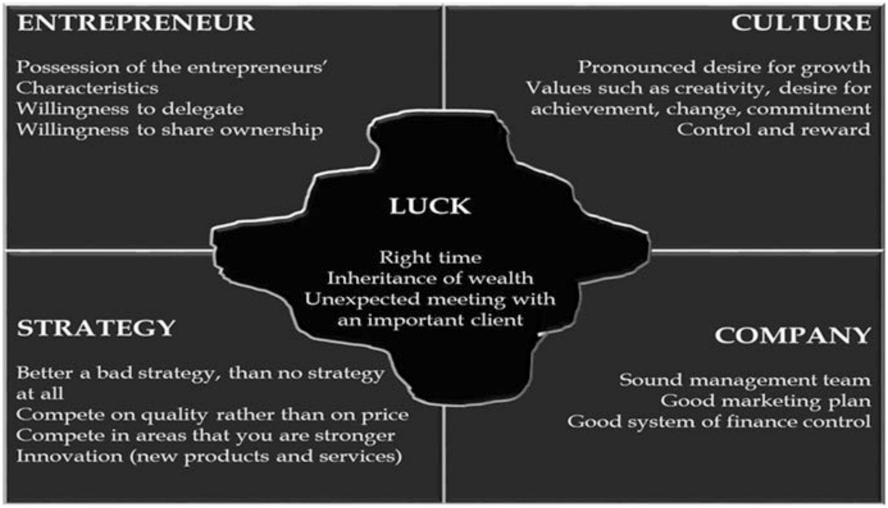

Fig. 8.1 Factors for a successful growth. **Source**: Based on Burns (2011, p. 291)

of sales, profits and/or number of employees after starting the business; *expansion* represents a more controlled increase of market share and company's size after the growth stage (Bjerke, 2007, p.162).

Growth of a business can be seen from several perspectives (Wickham, 2006):

1. *Financial growth* has to do with the business growth as a commercial entity and include increase of sales, costs and investments to achieve that sales and profits. Financial growth also includes the increase of the value of the company's assets as an important measure of its success.
2. *Strategic growth* has to do with the changes that the company make during the interaction with the environment as a whole. This is related with the way the company develops its ability to exploit opportunities in the market and the ways of using assets to create sustainable competitive advantage.
3. *Structural growth* is related to the company's changes with regards to the organization of the internal system, in particular, managerial roles and responsibilities, reporting relationships, communication links and resource control systems.
4. *Organizational growth* has to do with changes in processes, culture and attitudes of the company. In particular, attention is given to changes, which are related to the entrepreneur's role and style of leadership as the company 'moves' from being a small to a large company.

These perspectives and dimensions are not independent of each-other. These are just different dimensions of the same basic process—business growth. At the center of this process are the resources. A better and a more rational use of resources create greater value from them, which means and greater company's value. Rational use of

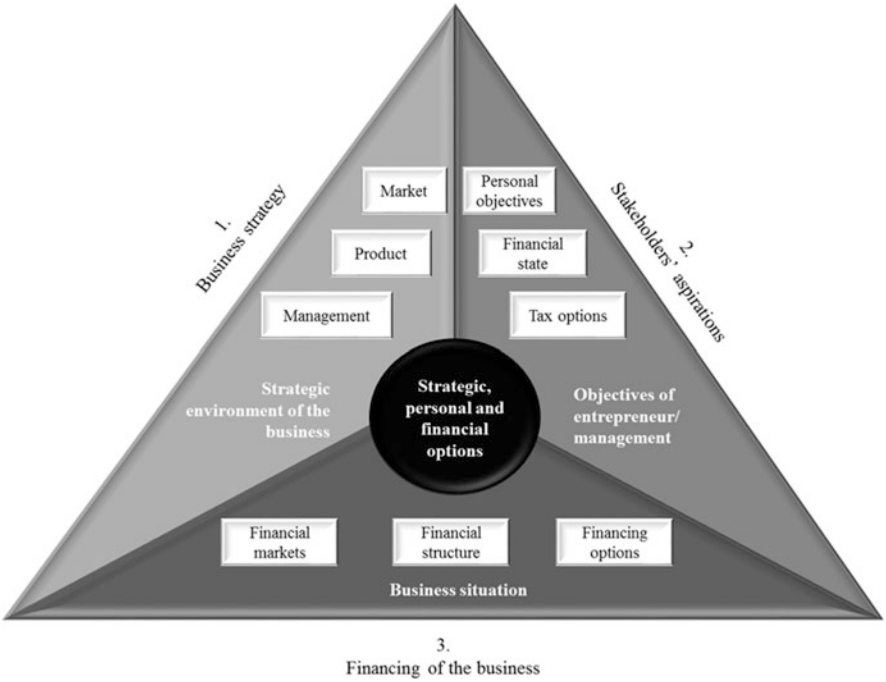

Fig. 8.2 Strategic, personal and financial objectives in an exit strategy. **Source**: Based on Schaper and Volery (2007)

resources greatly depends on the skills, knowledge and experience of entrepreneurs to take decisions.

In literature can be found different models that describe the entrepreneurial businesses' growth-cycle. Kuratko (2017) presented a model that consists of five stages (Fig. 8.2). Each of them is specific and each of them requires specific skills and strategies to cope with business challenges. These phases are as below:

1. *Development of a new venture*. The first stage is the foundation of entrepreneurial process and is based on creativity and assessment of options. At this stage, the entrepreneur networks of contacts are very important. During this stage are determined the overall company philosophy, mission, scope and direction.
2. *Start-up activities*. At this stage are included activities for developing a formal business plan, searching for capital, various marketing activities and developing of an effective entrepreneurial team. Marketing and finances are crucial at this stage.
3. *Growth of the venture*. At this stage, competition and other market forces can impose strategies' modification, and sometimes, complete reformulation. These new challenges will require from entrepreneurs to possess more complete entrepreneurial and managerial skills. This stage requires more and more efforts,

Table 8.1 Business life cycle

Stage	Activities	Priorities	Challenges
1. Idea	Development of innovative ideas Determining the commercial application of these ideas	Research and development Protecting intellectual property rights	Technical
2. Pre-start	Market research acquiring skills Deciding on business strategy Business plan development	Feasibility study Facilitation of partnership The 'business case'	Forecasting
3. Start-up	Generating funds Completion of components Business launching	Management Finances Marketing and sales	Development
4. Survival	Running the business Ensuring the business survival	Early growth Production Distribution	Operational
5. Expansion (and reward?)	Business development Finding an exit route	Growth Planning system procedures Management team	Planning and strategy

Source: Based on Bridge et al. (2003, p. 210)

therefore, entrepreneurs can be withdrawn from the current business and start something new. Entrepreneurial team can be complementary and can play important role in addressing these challenges of entrepreneurs and business itself. This stage is known as the stage of transformation from entrepreneurial one-person leadership to managerial team-oriented leadership.

4. *Stabilization of the business*. This depends on two factors, market conditions and the efforts of entrepreneurs. The market becomes mature (increased competition, indifference of customers to the company's products and services, saturation of the market with "me too", companies, etc.) Entrepreneurs should start thinking about where the company will be the next 3 or 5 years ahead. This stage somehow notifies the future of the company—it will rise and get further developed, or it will go toward decline and failure.
5. *Innovation or decline*. Companies that fail to innovate will die. Companies that will be financially successful will try to buy other innovative companies to ensure their own growth. Others will begin to develop new products and services to complement their current offerings.

Bridge, O'Neill, and Cromie (2003), through five stage process as well, explain growth and development of entrepreneurial businesses. This approach and features of each stage are presented in Table 8.1.

8.3 Characteristics of Fast-Growing Companies

Typically, fast-growing companies, often called "gazelles," have all or many of the following characteristics (Hisrich, 2014)[1]:

- Leaders with a clear vision
- Retention of small company traits
- Market-driven behavior
- Belief in customer service
- Shared focus
- Being flexible.

These companies have a ***leader*** (usually the founder/CEO) who has a clear vision for the venture in mind. He or she has a passion for this vision and communicates it throughout the organization. One entrepreneur had the company's vision and the basic aspects of its mission statement on a card the size of a business card and encouraged all employees to carry it with them.

Fast-growing companies try to maintain as much as possible ***desirable traits*** in the new venture in pre-start-up, launch and early stages. These traits include: a friendly cordial environment; a strong culture; and everyone knowing each other as much as possible and willing to do whatever it takes to get the job done. Some of these traits are hard to keep as the venture grows larger and larger and strong control and reporting systems are needed to support the growth.

A ***market-driven behavior*** is essential at all stages of the life cycle of the company, but perhaps more than any time to foster and stimulate growth. Developing a marketing plan that informs and allows the customer to understand and purchase the product/service with as little effort as possible is one aspect for achieving fast growth. Magna-Lock developed an automobile safety device that shut off the gas supply to the engine when engaged. To make the purchase and needed installation as easy as possible, the purchaser would set up a time for the device to be installed at home or in the parking lot at work through a fleet of mobile vans.

Fast-growing, well-run company make sure ***the customer is the focal point*** of all activities in the firm and not just the marketing ones (Nall, 2013). Making sure that the customer is king allows the correct return policies, right distribution policies and the correct marketing message, to mention just a few, to be developed and used. William Sonoma allows the return of any merchandise regardless of when purchased and sometimes without a receipt. Pepsi/Frito Lay has the policy of no store, regardless of the volume of sales, will be without stock for more than 24 hours. No wonder these companies are so successful in their market space.

[1]For a complete coverage and discussion of the process of growing a business, see Hisrich (2014) and Hisrich, Peters, and Shepherd (2017).

Most fast-growth companies like to ***share their mission*** and needs with other firms. This can provide resources and other support for the growing venture. Nature Brothers, a start-up seasoning company, was able to grow by sharing with key distributors who helped finance the inventory in the stores and even invested in the company itself.

Finally, every company needs to be ***flexible*** in order to grow. No matter how well planned and executed the launch and growth strategies are, everything you think will not happen will. It is hard to successfully launch and grow a business. Even Facebook, once it went public, had to face the reality that newness and income were important and necessary for shareholders to be happy and either keep the stock they purchased or buy new shares.

8.4 Growth Strategies

Growth strategies, typically, are classified as internal and external growth strategy. *Internal (organic) growth strategies* include the taken efforts the company itself, such as the development of a new product, activities related to existing products (improving their characteristics, increased market penetration through aggressive marketing, enlargement of their lines, etc.), and international expansion, which aims the increase of sales, revenues and profitability. Zappos.com, an online shoe and clothing shop based in Las Vegas, is a good example that has grown through internal strategies. *External growth strategies* intent to create and maintain company's relationships with third parties, such as mergers, acquisitions, strategic alliances, licensing, franchises, joint-ventures, etc., with purpose of penetrating to foreign markets and realize external growth (Barringer & Ireland, 2010). These methods will be discussed in Sect. 8.6. Suklev and Rexhepi (2013) noted that entrepreneurs need to know that choosing an appropriate strategy for a particular situation, at the right time, represents one of the greatest competitive advantage that an entrepreneur can invent. A considerable number of companies, when they shape their strategies, usually are based on the strategies of other successful companies. But, they should bear in mind that a strategy that is successful in a company, does not mean it will be successful in another one, considering that each company has its own distinctive features.

The successful launching of a business provides an opportunity to grow it through one of four growth strategies (Hisrich, 2014):

- Increasing sales in the existing market (market penetration strategy);
- Increasing sales by entering new markets (market development strategy);
- Increasing sales by developing and selling new products/services (product/service development strategy); and/or
- Selling a new product(s)/service(s) to new markets (diversification strategy).

A ***market penetration strategy*** for growth focuses on the existing product(s)/service(s) of the company in its existing market(s). This means concentrating on getting the customer to buy more of the product by taking more market share from competitors. It is often employed in business to business markets where a supplier has only $<100\%$ of the order of a particular product from a customer. Arnolite Pallet Corporation, maker of quality plastic molded pallets for production and/or shipping, always attempted to secure more than supplying just one third to one half of the pallets ordered by a customer after the customer was satisfied with the quality and delivery of the product.

Growing by selling the existing product(s) to new customers is employing a ***market development strategy***. These new customers may be on a demographic or geographic basis. A new geographic basis means selling existing products in locations instead of a new customer group based on age, gender or income in the present market (Wunker, 2011). Selling to a new geographically based customer group is a frequent strategy employed by business to business and business to consumer ventures and is frequently referred to as a market rollout strategy. This is a strategy employed by Vet-Stem, Inc., a venture producing a method for treating joint, particularly hip, problems in dogs by injecting a stem cell-based therapy. After successfully launching to veterinarians in its home city, San Diego, it then launched in Phoenix and then Dallas to successfully grow the venture at a good pace.

The ***product/service development strategy*** involves developing and selling new products/services to presently satisfied customers. The experience with satisfying a particular customer group often makes it easier to develop and market a new product/service to this group. Arthur Schofield, Inc. attempted to employ this strategy by marketing crushed oyster shells as a potential outside decorating option to satisfied customers of its delivered bark mulch. However, in this case, the satisfied bark mulch customers did not have an interest in the new product being offered.

The ***diversification strategy***, the one usually most difficult to implement, is to sell a new product(s)/service(s) into new markets. Often, this is accomplished by developing a new product(s)/service(s) in the same industry vertical just closer to the customer (forward integration in the value chain) or back toward the production of the present product(s)/service(s) (backward integration in the value chain). These provide growth opportunities related to the existing knowledge of the venture and in the case of backward integration, actually being the supplier to one's present venture. Green Mountain Digital employed a forward integration strategy by building Yonder, a social platform for nature lovers to help promote and sell its nature apps such as Birds of North America and Owls.

When IKEA opened its first retail store in China in 1998, it quickly faced strategic problems. While IKEA is focused on low-end consumers in developed markets, its prices were relatively high for Chinese consumers where Western brands were seen as aspirational products. The company had formed a joint venture in accordance with local laws, which helped it adapt its designs to better meet local apartment sizes. Furthermore, it changed its target customer to the young middle class. IKEA marketed itself as a high-quality, aspirational Western brand through social media rather than through its typical store catalog, which had easily allowed imitators to create local knock-off products. It also built factories and obtained more resources from within China to cut down on high import taxes. This and other cost saving measures enabled the firm to cut costs by more than 60% to further appeal to the price-sensitive Chinese consumer. IKEA was able to adapt and become profitable in China and has learned valuable lessons as it plans to enter other markets.

8.5 Management Actions Enabling Growth

While solid management decisions are necessary throughout the life cycle of the venture, they are particularly critical in the rapid growth stage as the venture continuously needs more time and money. Some critical management actions enabling growth are:

- Increasing human resources
- Increasing production capabilities
- Increasing raw material sources
- Adding distribution channels
- Accessing additional private capital financing
- Going public

One of the hardest, but necessary, actions is ***increasing human resources***, particularly hiring individuals at the management level. All too often the founder/entrepreneur has been taking a below market salary, putting the money back into the venture to create value. It is hard to hire someone at the vice president level and pay the market rate salary plus, in the United States, a 25% fringe benefit package. Yet the venture becomes stifled by the inability of the entrepreneur to make timely decisions. Sometimes below market salaries can be negotiated with stock in the venture that should be vested over a 3-year period to help ensure the individual will stay and grow the venture. Jameson Inns knew they had to hire a high-level marketing manager to grow the hotel chain from 40 hotels. The addition of this manager and other resources allowed the chain to grow the number of hotels substantially before selling to a private equity firm.

Growth of a company almost always puts strain on its ability to ***produce/supply the amount of product/service*** needed. This is not particularly the case for business to consumer ventures and consumer non-durable goods where a single store will take 12 of one item. Illumination Inc., a venture producing and selling Rainbow decals and stickies, needed to scramble to be able to supply the quality demanded by the 320 stores in the Zayre Corporation chain as well as the Toys R Us toy chain nationwide. Similarly, La Bella Terre, producer of flavored organic sugars, will have to be able to supply 12 of each of six flavors when the distribution expands nationally throughout the United States from the six stores in Arizona it is currently in.

When increased production capabilities are needed for growth, this is often accompanied by an ***increased need of supply*** for the production. Dumas Makt

H.K. needed to increase its supply of lower grade Tokaji wines when the distribution system to Moscow expanded to other cities in Russia as well.

Particularly in growing a business to consumer venture almost always requires adding ***distribution channels***. This of course requires management time and resources such as slotting allowances and increased inventory. Polymer Technology, the maker and distributor of the Boston Lens and more important the Boson Lens cleaning and soaking solutions, needed to expand its distribution in drugstores and large box stores as the company rolled out its lens throughout Canada and then the United States before being purchased by Bausch & Lomb.

The last two management decisions involve ***accessing additional capital*** as a growing business never has enough money. This is often done through accessing additional sources of private capital and in fewer cases going public—having an initial public offering and becoming a publically traded company. The latter will be covered as a growth activity later in this chapter. Often, a variety of private enterprise capital is obtained to fund the growth. This can be in the form of debt and equity as discussed in Chap. 7. Frequently, this takes the form of borrowing on factory accounts receivable particularly if they are from well-known distributors/ retailers and obtaining equity from private investors (angels).

8.6 Methods for Growing A Business

8.6.1 Going Global

One method frequently employed with the shrinking of the world and the age of the internet and online sales is going global. Some ventures are born global, meaning their company headquarters is in one national state and their initial market in a different one or, in other words, they cross a national boundary. Polymer Technology, the maker of the Boston Lens and the Boston Lens Solution, was located and manufactured in the Boston area but sold for the first years in the Canadian market starting in Toronto, that is, born global. The biggest factor that needs to be taken into account is the cultural climate of the country. Country tax policies on companies and individuals, import duties, government attitudetoward businesses, government support available (grants, incubators, training), the banking and distribution systems, and the differences in the customer and their purchasing behavior all impact the new culture the venture is entering and need to be taken into account before deciding on this method of growth as well as the country selection decision (Toften & Hammervoll, 2011).

There are several methods for going global and doing international business. These center around exporting, non-equity arrangements and equity arrangements (direct foreign investment). The risk involved in going global is reduced with exporting. Often, a new venture can test the validity of a new market by exporting before deciding to set up a corporate office or investing in a particular country. Exporting can take the form of indirect exporting or direct exporting. Indirect exporting, the easiest way to do global business, involves selling to a foreign purchaser in your present market who then does everything necessary to move the product/service into new markets or using an export management firm who represents many non-competing new ventures in specified foreign markets. They do not take title (ownership) of the product/service but sell to a customer on a percentage basis in that market similar to a manufacturer's representative in the home country of the venture. Direct exporting involves more international knowledge and involvement as it is done through selling the product(s)/service(s) either through an independent foreign distributor(s) or the company's sales person in that country. Sometimes a mixed policy occurs in direct exporting as was employed by Polymer Technology in going global. The company used a company sales person of German origin and background in Germany to sell its Boston Lens and Boston Lens cleaning and soaking solutions due to its large market potential and an independent foreign distributor in Italy.

Another method of going global is using some type of non-equity arrangement such as licensing, franchising, turn-key operations and management contracts. Franchising and licensing are discussed later in this chapter. Fiat employed a turn-key operation when it sold, set up and operationalized a manufacturing plant of one of its older car lines it were no longer producing in the Soviet Union. The Lada was then successfully produced and marketed by the Soviet Union until production ceased in 2013.

Direct foreign investment, such as investing money in a foreign operation, is the riskiest way of going global as there is capital investment involved that often cannot be fully recouped if problems occur. One way to reduce the risk is by forming a joint venture, which is discussed later in this section. When making a direct foreign investment two issues need to be addressed—ownership and control. Particularly in developing economies, it is better to take control at the start and invest over time so that the government of the country is aware that new direct foreign investment may be forthcoming depending on the degree of success achieved. The amount and timing of the new investment that increases the ownership can be specified in the original purchase agreement. General Electric acquired Tungsram, a manufacturer of light bulbs in Budapest, Hungary, in three stages over a period of time but had complete control of operations on its initial investment.

8.6.2 Strategic Alliances or Acquisitions

The second method of growth is through strategic alliances or acquisitions (Yi, 2012). Strategic alliances can be based on internal transactions or market transactions and typically involve long-term suppliers, marketing/distribution partners or joint ventures. A strategic alliance involves cooperation between two or more ventures with the arrangement going beyond price and top-down orders. It is basically an agreement between two or more ventures to cooperate versus competing by sharing the costs, risks and benefits of addressing a market condition or constraint. The success of the strategic alliance relies on the ease of information exchange and sharing, the amount and level of joint activities and joint problem solving, and the decision-making balance of power. A venture (company) can have alliances with competitors, suppliers, customers, governments or universities. Some of the unique characteristics of alliances are: immediate presence and size; immediate and externally improved performance expectations; a common domain or experience base of the participants in the alliance backing; and frequently involves crossing industry boundaries as well as national boundaries. A strategic alliance can take a variety of forms and different levels of degree. There are two basic types—partial ownership and contractual control (joint ventures and partially owned subsidiary) and contractual control only (R&D partnerships, exchange of personnel, research contracts, technical assistance, joint bidding/purchasing activities and long-term contracts).

An often used form of strategic alliance is a joint-venture, an organizational form of cooperation between two or more sponsoring companies that creates a separate entity with the sponsoring entities remaining. It is sometimes referred to as an equity-joint venture as the sponsoring partners of the new entity own it according to their respective pro rata shares. This ownership percentage split varies by the cultures, national laws, tax incentives and the purpose and objectives of the joint venture. While a joint venture usually develops its own organization structure and goals, a typical joint venture formation involves the partners agreeing on purpose, resources to be provided by each partner, identification of activities to be performed and the reporting partner(s), identification of activities with substantial joint venture autonomy, expected duration, specific milestones to be accomplished and the benefits to be received by each partner. Many joint ventures do not succeed because the objectives and therefore the benefits received by each partner are not clearly defined. General Electric's acquisition of Tungsram was called a joint venture even though it was not because a new entity was not formed due to political and cultural reasons.

8.6.3 Franchising or Licensing

The third method for growing a firm is through franchising or licensing. The basic premise behind the two is the same but one (franchising) involves the distribution system and the other (licensing) involves the manufacturing area. Franchising is a method for growing a venture that involves expanding the distribution or services of the product(s)/service(s) of the venture through independently owned distribution establishments (franchisees) who will use the logos, trademarks, marketing materials and operating procedures of the existing venture (franchisor). A venture decides to grow by franchising when it does not have sufficient capital, management talent or marketing techniques to expand the distribution of its product(s)/service(s) on its own. There are many advantages of growing through franchising including: (1) a strong possibility for rapid market expansion with minimum capital expenditures; (2) direct managing responsibilities become the franchisee's obligation, allowing the franchisor more freedom to do other things; (3) the franchisee has pride of ownership and self-motivation because of his or her capital investment and stake in future profits, resulting in lower costs and higher profit margins; (4) more national and local advertising dollars being available; (5) an increase in buying power resulting in lower purchase prices; (6) R&D facilities being available; (7) the franchisor having a steady cash flow from royalties; (8) the franchisor enjoys control over franchisees through the established contract provisions; and (9) some limits of liability as franchisees generally are not held to be agents of the franchisor in the event of injuries due to negligence. There are several disadvantages to franchising as a growth method including the independence of the franchisee, relinquishing the rights to the market specified in the agreement, high costs and decreased net benefits to the franchisor that would not occur in developing the distribution channel on their own.

Licensing is similar to franchising but focuses on the manufacturing/production side of the business as well as the market side. As such, it is a much broader agreement between two partners but provides a nice way to grow a venture. Favorable circumstances for licensing include: (1) venture lacks capital, managerial resources, knowledge or commitment in a market; (2) venture wants to test the viability of a market; (3) technology is not central to the venture's core business; (4) strong possibility of acquiring new technology; (5) market too small to warrant any other activity; (6) laws of country restrict other options; (7) risk of nationalization in country too great; (8) licensee could become a future competitor; and (9) rapid rate of technological change.

8.6.4 Attracting and Retaining Employees

The next method for growth is growing by attracting and retaining employees. For a new venture at any stage in its life cycle, attracting and retaining good, strong employees is important but it is perhaps particularly key when growing the venture. A venture needs to establish a process for finding and recruiting the best possible candidates. This process has four basic steps: finding candidates; interviewing; hiring; and an employee handbook.

The process starts by finding the right candidates, which is usually best accomplished through contacts and word of mouth. The entrepreneur and management team should aggressively use their own personal contacts as well as those of their network, that is, board of advisors, fund providers, suppliers, customers and professors. While this usually produces the most suitable candidates, advertisements in appropriate trade outlets and postings on job boards can also be used. In order to fund and hire the right candidate, a proper job description needs to be developed defining the skills, expertise and experience of the ideal candidate. This profile is then used to establish the questions to be used in the interview for each job. The key to a good interview is developing the thoughtful questions that will reveal the strengths and weaknesses of each candidate along the profile developed within the legal limits of the country. The legal side in the United States means staying away from such topics as age, religion, ethnicity, sexual orientation and marital status. Throughout the interview, the vision and the mission of the venture needs to be precisely shared as well as performance expectations.

The actual hiring process involves developing the compensation package and having the right forms. A compensation package is more than money and includes economic and non-economic aspects. The elements of the economic package include: cash; equity; pension; risk program; vacation; working hours; and the medical/dental plan. Using these elements, the economic part of the compensation plan tailored to the extent possible should be developed to fit the needs of the ideal candidate. Providing equity that vests over a period of time, usually 3 years, not only attracts a good candidate but motivates them to stay for at least the time of the vesting period. Where possible, the economic part of the compensation plan should be based on performance, which nicely meets the requirements of any strong candidate.

The non-economic parts of the compensation plan might actually be the factors that are very attractive to a candidate. These include the environment, career potential, training and professional development and image. Noteworthy Medical Systems was able to attract a strong candidate due to its Cleveland, Ohio location, which had a lower cost of living and very affordable lower-cost quality housing than would be the case if the candidate took an offer in Silicon Valley or Boston. Similarly, the vision of the firm and the entrepreneur can provide an exciting opportunity for a strong candidate. Besides the compensation package in the hiring process, in the United States, forms such as non-disclosure agreements, non-compete agreements, W2, social security, 401 K and insurance benefits must be executed.

The final part of the hiring process is the employee handbook. This part of the process is often overlooked by the entrepreneur and is perhaps most easily developed by the first or second employee hired. Having the employee develop the handbook will ensure that the important issues will be addressed, making the handbook a useful tool. It is an essential aspect when growing the venture and adding new employees at a faster rate as it spells out performance standards, codes of behavior and general terms and conditions of employment. It needs to be reviewed and updated on a regular basis.

8.7 Exit and Harvesting Strategies

The aims of launching a business can be different, as well as are different the entrepreneurs. Some entrepreneurs launch businesses, which after a reasonable period of time (according to many surveys, somewhere after 5–6 years) to sell and earn from the investment made. Another group of entrepreneurs decide to sell only a part of the business and still have the control in their hands. Others, slowly withdraw and transfer their wealth and management to their successors or other family members. A significant number of entrepreneurs wants eternally to remain on 'the top of the pyramid'. Some others, necessarily bankrupt and go out of the business. Exit from the business and harvesting the fruits of that business is a very important process for entrepreneurs. Some people say that if a company's founding and growth are the first two steps of creating wealth, then exit is the third one (Schaper & Volery, 2007, p. 386).

Exit and harvesting a business is not a simple leaving of it. It is a much more complex process. It is suggested that exit from a business should be planned very carefully by entrepreneurs, even in those cases where they do not plan to sell their business. Entrepreneurs should know that one day they will retire, or it may be a sudden death or illness and all these determine unfavorable situations for the business. A good exit plan of founding entrepreneurs can mitigate these consequences and those who will follow the business will be able more easily to continue the same and be successful. As presented in Fig. 8.2, beside many elements, three are most important that should be considered by entrepreneurs when they plan exit and harvesting: (1) Strategic elements related to the business environment; (2) Entrepreneurs' personal aspirations; and (3) Financial situation of the business.

Business Environment-Related Strategic Elements Entrepreneur's exit could be attractive only in cases when is identified a great interest by potential buyers about the company. The company must necessarily prove that it offers quality products/services in the market and have a large number of loyal customers. Here should be clearly identified that the company is well-positioned in the market, what enables further development and growth, even after the founding entrepreneur's leave.

Entrepreneurs' Personal Aspirations It is proved many times that entrepreneurs are closely connected with their companies. They are very important part of their lives. Therefore, the decision to exit cannot be easy and cannot be detached from the personal entrepreneurs' goals and aspirations. The lack of a clear understanding and expressing of what is most important in the entrepreneurs' life can lead to wrong business exit-related decisions. If an entrepreneur thinks that he should continue to lead the business further and wants to do so, he must announce it to the others involved in the business, as he should do the same if he establishes a company with purpose to raise it to some extent, to increase its value and sell it in order to gain from his investment.

Business Financial Situation Financial statements are another important element that should be considered when deciding to exit and sale the business. A business with a huge debt is unlikely to be listed on the stock exchange and be sold to different investors, or attract any strategic buyer, who will express an interest to buy the business that is for sale.

Entrepreneurs have several options to choose how to exit and harvest the business. Some of the most important are discussed below.

Trade Sale A trade sale represents the sale of entire company to a third party. This exit strategy is implemented in a way where all of the company shares are usually sold for cash, or in some cases, exchanged for assets that can be easily converted into cash. Usually, the buyer is a very large company, well-established in the market, which in the company that is for sale sees as a foothold for further technological development. Therefore, as a buyer can be a company that operate in the same or similar sector of the company itself. As a buyer may be competitors, suppliers or customers as well. This strategy is also known as a strategy of acquisition.

Management-By-Out (MBO) Under a MBO exit strategy, the founding entrepreneur sells the company to the leading managers. But usually happens managers to not have the necessary money to buy the company and as a good opportunity to keep the company in their hands are venture capitalists, wealthy investors, who provide capital and business knowledge in the same time. MBO as strategy is more difficult to be accomplished because both, the managers and founding entrepreneur, know almost all company secrets and negotiation process about the price is too cumbersome, because managers usually contest the price that entrepreneur asks.

Management-By-In (MBI) MBI represents that exit strategy, where the founding entrepreneur sells the company to other managers, from outside the company. These managers usually are experienced, operate in same industry and want to buy a company—where besides being managers, they would like to be owners of a particular company as well. The problem here is that, how and where to search for such managers?! Accountants can be a great help in this situation, considering the nature of their work and contacts with many people in the business world.

Employee Stock Ownership Plan (ESOP) According to this strategy, the founding entrepreneur enables all employees (not only managers, as the MBO strategy) to buy shares of the company and become its owners. Under ESOP system employees establish a trust that borrows money against the future profits. This money buys the founding entrepreneur's shares and allocate them to employees' retirement accounts as the loan is paid off (Hisrich et al., 2017). The buying process is done gradually and can last 2–3 years. This strategy is good for the company as its culture and values are saved and the company can continue working with profit, but can be unfavorable for the founding entrepreneurs in those cases where they want to come faster to cash, because ESOP usually lasts longer than other exit strategies.

Initial Public Offering (IPO) IPO represents an exit strategy, where founding entrepreneur transfer his company from private into public one sell its shares through the stock-exchange. In this way, entrepreneurs tend to harvest the fruits from its business. This strategy is discussed in Chap. 7 as well.

Family Succession Some entrepreneurs decide to retire and entrust the company to their heirs or other family members. This strategy is quite difficult. Some of dilemmas that arise in this situation are the following: Whether the heirs would be ready to continue the business in the same way as the founding entrepreneurs; do they want to be in the same business established by the parents; or which of the heirs would be chosen to lead the business?! The issues related to the succession process are broadly discussed in Chap. 11.

Thus, as it can be seen, any respective strategy that can be chosen by the entrepreneur to exit the business, is accompanied by different vicissitudes and difficulties—this is why this is not an easy process. It is suggested that during the selection and successful implementation of a respective strategy to be consulted experts, such as accountants, lawyers, business valuers, renowned professors etc., who would help the entrepreneur to take the right decision at the right time.

8.8 Summary

The chapter began with a discussion of identifying the factors that influence the growth of the entrepreneurial ventures, followed by the different perspectives of growth—financial growth, strategic growth, structural growth and organizational growth. Then the growth cycle of the venture and the characteristics of growth companies were presented followed by four overall growth strategies—market penetration, market development, product development and diversification. The chapter concluded with a discussion of exit options from a business.

Case Study: Kantara Wine

Situational Summary

Kantara wines were being produced by O.A. Ltd., in Lefkosa, known as Nicosia prior to the Turkish invasion of Cyprus. The wines were made from fine grapes grown on the island. A problem, however, was that these wines had at least a 10% alcohol content, and 98% of the population of Northern Cyprus adhered to Islam, a religion which prohibits the drinking of alcohol. An embargo prevented the export of Kantara wines to the Republic of Cyprus or to anywhere else. Executives were seeking ideas.

Report from Cyprus: Ethnicity and Enterprise

An island in the Mediterranean Sea, Cyprus was, for several centuries, an important center for international trade. It was ruled by the Venetians until conquered by the Turks in 1571. The demise of the Ottoman Empire resulted in British rule until the Republic of Cyprus became independent from the United Kingdom on August 16, 1960.

While the majority of the islanders were traditionally ethnic Greeks, speaking Greek and practicing Greek Orthodoxy, a Muslim minority gradually gained significant power. Communal strife in 1963 led to segregation of the two ethnic groups in Cyprus. In June 1974, Turkish troops landed on the island, occupied 37% of its area and created the Turkish Federated State of

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Cyprus, the president of which declared the independence of a Turkish Republic of Northern Cyprus (TRNC), on November 15, 1983.

This resulted in two de facto autonomous areas, including a new Muslim republic as well as the internationally recognized Republic of Cyprus (with a Christian majority). The two are separated by the "Green Line," a United Nations buffer zone, covering 4% of the island's territory.

One Island: Two Philosophies

To the Greek Cypriots, Cyprus is an economic entity. The name "Cyprus" is derived from the Greek word for copper, which is the island's principal economic resource. The flag of the Republic of Cyprus is white, with a copper-colored silhouette of the entire island. Below the silhouette are two olive branches symbolizing the hope for peace between the island's two ethnic communities.

In contrast, the TRNC is considered a religious entity. Its people and its policies have been more concerned with isolation from Christians than with economic issues. The flag of the TRNC consists of an Islamic crescent and star, between two red stripes.

Four out of five persons on the island of Cyprus are Greek Orthodox Cypriots, while the Turkish Muslims comprise 18% of the population. Almost all of the Greek Cypriots reside in the Republic of Cyprus; only 0.5% live in the TRNC. As for the Turkish Muslims on the island, 98.7% of these reside in the TRNC, while 1.3% live in the Republic of Cyprus. There are also small minorities including Maronites and Armenians, of whom 99.2% live in the Republic of Cyprus.

The population of the Republic of Cyprus was estimated at 603,000 in 1996. Of these, 95% were Greek Orthodox. The labor force amounted to 285,500, 30% of whom worked in industry, as compared to 13% in agriculture.

Turkish occupation of the north resulted in 180,000 Christians being expelled. The TRNC consequently had a population of 135,000, 98% of whom were Turkish Muslims. This represented a workforce of 74,000, 23% in industry, and 25% in agriculture.

The Greek Cypriot economy is much more diversified, and more prosperous than its northern counterpart. Exports from the Republic of Cyprus (including cement, clothes, footwear, fruit, vegetables and wines) span the European Union from the United Kingdom to Germany and Greece. The TRNC exports limited quantities of potatoes to Turkey. There also appears to be considerable heroin in transit. While the Republic of Cyprus has had consistently positive growth in the 5 to 8% range, that in the TRNC has been negative 5%. Per capita GNP is over four times greater in the south than in the north. In 1996, per capita GNP in the TRNC was estimated at $3000 US, compared to $13,000 in the Republic of Cyprus. Inflation in the south

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rarely exceeds 5%. In the TRNC, it has surpassed an annual rate of 100%. Turkey, is the only country in the world to give recognition to the TRNC and the Turkish government also sends financial aid to its puppet republic. Assistance amounts to about 35% of GDP.

A considerable amount of time and money has been allocated to a special committee responsible for renaming towns and villages which have had Hellenic names for thousands of years. For example, Kyrenia is now known as Girne, while the Turkish part of Nicosia, the capital, is called Lefkosa. New unilingual Turkish signs have replaced bilingual ones which used to display English as well as Greek. In contrast, bilingual and trilingual signs are still the norm in the Republic of Cyprus where road and street signs are Greek and English. A few signs include Turkish, too. Ironically, a road sign in Lefkosa explicitly indicates the way to Nicosia, although crossing is restricted. On the other side, however, a huge "No Entry" symbol marks the direction to Lefkosa, where crossing is usually less problematic.

As a result of the British school system, set up under colonialism in Cyprus, almost everyone south of the "line" speaks English. They have no qualms discussing the hardships they are suffering which the Turks put them through.

The Republic of Cyprus has a large merchant marine, as the government offers a flag of convenience registry to about fifty countries. Over 700 Greek ships are registered in the Republic of Cyprus, as are 56 ships from Russia, 45 from the Netherlands, 27 from Japan, 25 from Belgium, 21 from Great Britain, 17 from Spain, 14 from Switzerland and 13 from Hong Kong. Major ports include Larnaca and Limassol. In contrast, the ports of the TRNC are not recognized by the international community and are considered illegal, even by the Republic of Cyprus. Therefore, someone landing in Famagusta (locally known as Gazimagusa) or Kyrenia (Girne in Turkish) is liable for arrest if and when attempting to enter the Republic of Cyprus from the TRNC.

The TRNC: An Ethnographic Account

Arriving in the TRNC can be an experience in itself. In contrast to the luxury ships which arrive in the Republic of Cyprus (from Greece and Israel), those which link the TRNC with Turkey cater to a different clientele. No country, other than Turkey, permits traffic to or from the TRNC, either by air or by boat.

Overstuffed baggage is piled four feet high on hand-made trolleys. Gypsies dressed in unmatching stained clothes line the corridors and the main decks while their children are left to roam. A man walks by, a gun tucked in his pants, while another carries a baton. There are no cabins, only rooms, each with a television blaring, sticky vinyl seats and floors heavily dotted with cigarette butts. Cockroaches scurry by. Adding to the view is a lingering smell of a combination of past and present travelers. The only

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women's washroom open has excrement configured in S-shapes on the floor, beside the designated facilities; the slow decay of feces and urine halts anyone attempting to enter. The water is murky and the mirrors clouded, not that passengers, glowing from the suffocating heat of uncirculated air, really want to see themselves under such conditions. There is drinking water available from a tap and a plastic cup, tied to a rope, sits beside. There is no way of putting one's head underneath the faucet.

Once the boat has docked at Famagusta, a port considered illegal by international authorities, the customs rituals begin. The disorderly line-ups of gypsies behind the barred gates adds to the increasing pressure of people's nerves. By looking into their unfeeling eyes, one senses the wrongs committed in the past. A passenger can easily imagine having been sent as a prisoner of England to Australia in the 18th century.

A customs official arrives, coffee in hand, opens one gate and quickly closes it behind him. He yells a few words and sits down as if to say, "Don't bother me until I finish my coffee." The pressure rises yet another notch and finally a dozen passengers are permitted to cross the first barrier. A physical fight breaks out in front of the custom's control desk, and another commotion brews behind the gate. It will be hours before all pass through. Some will have their passports stamped. A TRNC stamp in one's passport, however, bars the bearer from entering Greece. Furthermore, landing on Cyprus from a TRNC port prohibits entry by land from the TRNC to the Republic of Cyprus. Illegal ports of entry include Gazimagusa (formerly Famagusta), Girne (formerly Kyrenia), and Karavostasi (formerly Karavas) as well as all of the airports in the TRNC.

At the United Nations base between the two countries, peacekeeping, Australian Civilian Police explained two options for individuals trying to cross: (1) a jail sentence of 4 months as was recently given to an unsuspecting Dane; or (2) possibly being shot.

There are no hotel representatives to greet the passengers as they emerge from the port, only shady characters hanging around, waiting. . . Daring to ask for directions to the city may result in cold stares and muffled answers. Keeping one's belongings in close proximity is advisable, and finding the center of town by intuition usually works well.

Any transaction in the TRNC must be carefully monitored as folded bills, double counted, are often a strategy for increased revenues, even at banks. Tourism has not flourished here. Hotels, as a result, are few and far between. Many signs exhibit that Otels and Pensions have existed; however, many have been boarded up.

Turkish residents have no qualms in expressing their feelings of hatred for the Greeks and Christians alike. Opinions are offered so openly and as a matter of fact, that an uninformed listener might be convinced that there

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really is only one side of the story. Furthermore, such stories are supported by pictures of the war where Orthodox priests are seen shooting at Turkish Muslims. Postcards carry prose that displays the Turks as innocent victims.

Soldiers patrol the streets and in the heat of noon, they are the only people to be seen. They are clad in khaki uniforms and hard hats with the letters AS12. United Nations soldiers are to be found at designated posts, sporting blue hats and multicolored green army fatigues. It has been over 20 years since the cease fire, yet it feels like the war has just ended, or maybe not yet. Bullet holes mark many walls and monuments. Ruins of the war can be seen everywhere, partially standing, as grim reminders of the mass shootings and lootings of the past. Antique shops display many beautiful pieces that one cannot help but imagine to have been stolen from former residents removed from their homes. The irony lies in the fact that should tourists make a purchase, such pieces will be confiscated upon departure, as these are not exportable.

One of the tenants for the war was to stop the infiltration of Christian values on Muslims. Old churches are now used as mosques and bottles of alcohol take up more shelf space than do soft drinks and juices.

The Republic of Cyprus: An Ethnographic Account

Docking at the internationally recognized port of Limassol tends to entail a smoother arrival. Passports are stamped on the ship and although the bag search is thorough, the line-ups are short. An information desk, exchange offices and car rental companies are all set up to accommodate tourists and business people alike. The shipping yards are full of containers destined for Europe, Asia, America and Africa. Ships headed for the Netherlands, Cambodia, Liberia, Jamaica, Egypt and elsewhere have minimal procedures with which to contend.

While Limassol is the port of entry for passengers traveling by sea, the major international airport is at Larnaca. In response to the demands of ever-growing tourism and foreign investment, a new airport was recently built at Paphos. Cyprus Airways is the national airline of the Republic of Cyprus, linking it to the world; of course, there is no traffic between the TRNC and the Republic of Cyprus.

Upon first glance, much of the Republic of Cyprus carries the same traits as do other Greek islands. Each appeals to a different type of tourist and/or investor, and the Republic of Cyprus is no different, except that it has had a more dramatic history in recent years. A good portion of its lush forests had been bombed and burned by the Turks in the 1970s. Replanting them has taken time, but the results are now being seen all over the rolling hills of the south. Many rangers patrol the areas, ensuring the success of the projects.

It is, however, the capital city, Nicosia, which displays most of the scars of the war, both in its urban development and its people's eyes. There is a

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bitterness that can be felt even without words. All along the border there are houses left with broken doors and walls. Sand bags are still piled. Soldiers, standing tall on balconies guarding their posts, are using their binoculars as if an ambush were about to happen. At the border crossing, a cross can be seen leaning against a dilapidated building, a map of Cyprus hung on the posts and a knife jabbed in its heart, where Nicosia lies. Red paint pours from the soul of this island.

At this crossing, it is possible to obtain a day pass to meander to the "other side." A list of instructions must be followed whereby nothing is allowed to be purchased and a curfew of 5:30 p.m. is imposed. The visa issuer states that he cannot guarantee a person's safety should one choose to cross the line.

Interestingly enough, life on the south side of Nicosia goes on and productivity is seen more vividly than on the TRNC side. A restaurant manager solicits new clients, and makes sandwiches. While his clients are eating, he fixes a window. There are five ice cream shops within a few meters of one another. Recent advertising posters and signs are replacing those from before the war, some of which are still visible. Increased marketing costs, investment and demand have augmented prices. People pay $1.50 US for a tea, in the Republic of Cyprus, whereas in the TRNC, the same averages 15¢ US. Living expenses are several times more expensive on the former side than on the latter.

Big brand names and international franchises such as Body Shop, Kentucky Fried Chicken and Holiday Inn, are prominently featured. Of course, Western influence also brought a number of sex shops, cabarets and hourly room hotels. It is possible to acquire a room for $20 including sex. A lot more "nightlife" is exhibited as the sun begins to set.

Questions

1. Discuss the potential barriers facing *Kantara wines* in its further growth path!
2. What could Kantara wines offer to Northern Cyprus citizens? Executives are seeking ideas!

Source: This case is written by Professor *Leo Paul Dana* (Montpellier Business School, France) supplied for this book.

Questions for Discussion

- What factors influence the growth of entrepreneurial business?
- Discuss the different perspectives and dimensions of growth!
- What are the main characteristics of fast-growing companies! Discuss them shortly!

- Explain the management actions enabling growth of entrepreneurial businesses!
- Describe the four major growth strategies!
- What are the main exit options from an entrepreneurial business?

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9 E-commerce Challenges and Entrepreneurial Manager

Learning Objectives
After reading this chapter, you should be able to:

- understand the impact and the use of the internet in the world,
- define e-commerce,
- identify the differences between electronic and traditional commerce,
- differentiate electronic commerce and electronic business,
- differentiate the various types of electronic commerce,
- know the impact of electronic commerce in the company,
- identify the company's benefits from electronic commerce,
- recognize the barriers of electronic commerce implementation

Profile: Jack Ma—Alibaba

Jack Ma (Yun Ma)—from an English professor, to the wealthiest man in China; this is a really inspiring story. Jack Ma was born on October 15, 1964 in Hangzhou, China. He was the middle child of a family of musicians, had an older brother and a younger sister. As a young child he always expressed his desire to learn English, to be more exact, when he was only eight, then president of the United States, Richard Nixon visited his hometown and from that moment Ma would do anything just to be in contact with people who spoke English. Every day with his bike he went to a hotel near his house to meet tourists and he would offer them a walk around the city in exchange with 'any English word'. Even the name Jack was taken from a tourist. He believed that the future depends on education, he applied three times to enroll in collage and he failed, at one point he enrolled at the Institute for teachers in Hangzhou and in 1988 he graduated. He immediately started looking for a

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R.D. Hisrich, V. Ramadani, *Effective Entrepreneurial Management*, Springer Texts in Business and Economics, DOI 10.1007/978-3-319-50467-4_9

job. He was rejected all the time, and when he would find a job in a short period of time they would fire him. Something similar to this happened in the famous KFC. As once he said: "I failed three times in college. I applied 30 times to get a job but I was always rejected. When KFC came to China for the first time, we were 24 to apply and I was the only one dismissed. I wanted to go into the police but I was the only one not accepted. I applied 10 times to Harvard University in the US and I was rejected." After a while he was employed as an English teacher at the local university, for a monthly salary of only $12. That was a small salary but that didn't stop him from working because he loved the work and the students.

Jack Ma was a man who had a lot of faith in himself and he believed that one day he would change his fate. He had no knowledge about the internet or coding. He learned about these on a trip to the US in 1995. The first word that he searched on the internet was 'beer', but he was surprised to see that there was not even one company in China that produced beer and from that moment he decided that as soon as he will get back to his hometown he will open an Internet company in China. He opened a website for China and from nowhere he started getting e-mails from people asking who he was and wanted to know more about him. As Ma says, his first website was really bad, but he wanted to convince his friends that the internet existed. He tried twice to do business and failed. After a few years he called 17 of his friends in his apartment to convince them to invest in him and his vision to open an online marketplace, which he will call 'Alibaba'. The idea for the name came to him while he was in a coffee shop. When he came up with the name, he stopped the waitress at the coffee shop and asked her whether she had heard about Alibaba. She replied with a 'yes'. He then continued to ask her 'what do you know about Alibaba?' She briefly answered: 'Open Sesame'. Then continued asking people in the street about Alibaba and when he found out that they have all heard of it, he said to himself 'yes', this is what I am looking for. He did not wait long and decided to call the company 'Alibaba Online' which started in 1998. In 2001 Alibaba.com started to show profits. In 2003 he founded the company Taobao, as an electronic commerce platform, than followed Alipay (2004), Tmall.com (2008), Juhuasuan.com (2010), Aliexpress.com (2010) and other. In 2005 Yahoo.com invested $1 billion in 'Alibaba', in exchange for 40% ownership. In 2007 Alibaba.com successfully was listed on the Stock Exchange of Hong Kong, and in 2014 announced the initial public offering (IPO) in the US, which they did on September 19th marking the biggest IPO in the history of Stock Exchange in New York. This made Jack Ma the wealthiest man in China, whose wealth was estimated around $25 billion. However wealth did not change him, he still was a casual and a modest man, a virtue that his friend Xiao-Ping Chen confirms. According to Ma, great wealth means responsibility, where in an event he said: "If you have less

(continued)

than $1 million, you know how to spend money. . .but $1 billion, are not your money. . .the money that I have now are a responsibility. They represent people's faith in me". He feels the need to spend money "on behalf of the society". For his achievements he was honored with various awards by international organizations and international and prestigious journals such as: World Economic Forum, Forbes, Businessweek, Time Magazine, etc.

Source: This profile is written from the authors based on information in: Business Insider, http://www.businessinsider.com/jack-ma-on-the-downsides-of-being-a-billionaire-2015-6; Forbes, http://www.forbes.com/profile/jack-ma/; How an English teacher conquered China: Wisdom of Jack Ma condensed into 33 quotes, http://yourstory.com/2015/05/jack-ma-quotes/ (Accessed: June 23, 2015).

9.1 Introduction

This chapter is about electronic commerce (e-commerce). The chapter begins with the explanation of the nature of e-commerce, where are represented some definitions of e-commerce, differences between e-commerce and traditional commerce, pure and partially e-commerce. In other sections are discussed the basic types of e-commerce, benefits from e-commerce and barriers of e-commerce implementation.

9.2 Nature of E-commerce

Despite the size of the company, traditional companies must understand that today, selling products and services through the internet is not a luxury but a need. Entrepreneurial managers, who think not to be included in electronic commerce, they expose themselves to very high risks. In the modern world, every company that claims to be a few years ahead from others, technology and internet-processes must be essential part of their competitive advantage.

Access on the internet nowadays is a must for all size companies, because that is where customers are. In the US, in 2008, people spent on average 16 h a month online (without including reading newspapers and sending e-mails, totaling about four additional hours), which is 2 h more than in 2006 (Center for the Digital Future, 2008), or globally, people spend 35 billion hours online (Social Media Today, 2012). Not surprisingly, by an investor this is called '*a $50 billion opportunity*' (Morrissey, 2012). In Fig. 9.1 are presented the hours spent online (in percent) by activities.

Customers have adapted to the internet much faster than any other major innovation from the past. Internet has reached an audience of 50 million people,

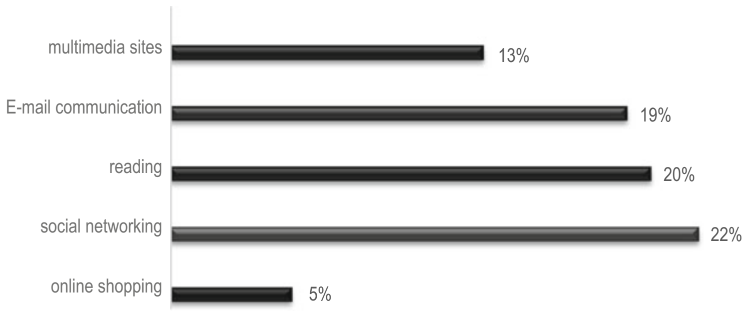

Fig. 9.1 How people spend their time online? **Source**: Drawn by the authors based on the data in Social Media Today (2012)

Table 9.1 Internet users in the world in 2015

Region	Population (2015)	Internet users (2000)	Internet users (2015)	Growth rate 2000–2015 (%)
Africa	1,158,353,014	4,514,400	318,633,889	6958.2
Asia	4,032,654,624	114,304,000	1,405,121,036	1129.3
Europe	827,566,464	105,096,093	582,441,059	454.2
Middle East	236,137,235	3,284,800	113,609,510	3358.6
North America	357,172,209	108,096,800	310,322,257	187.1
Latin America/ Caribbean	615,583,127	18,068,919	322,422,164	1684.4
Australia/Oceania	37,157,120	7,620,480	26,789,942	251.6
Total	7,264,623,793	360,985,492	3,079,339,857	753.0

Source: Based on Internet World Stats (2015)

only the first 4 years, compared to radio and television where they needed 38 years, respectively 13 years to reach this number; Facebook reached 50 million users in just 2 years (Scarborough, 2012), and today Facebook counts 936 million users (Internet World Internet World Stats, 2015).

The beginnings of electronic commerce dates from the 70s of the past century, with the introduction of *electronic fund transfer* (EFT) in the banking section. Then, the use of electronic commerce was limited only for large corporations and in a very small number of small businesses, and in terms of how through the EFT systems they were able only to transfer money from one bank account to another and nothing more. Afterwards the *electronic data interchange* appeared, known as EDI, with this the list of the elements that were being transferred and exchanged grew and a lot of manufacturers, retailers and service providers joined the rough competitive contest.

With the internet commercialization in the 90s and the continuing growth of the internet users (Table 9.1), electronic commerce made a big ‘blast’ and began to be used by great number of companies. The internet and its development are creating a new order in the industry and all of the companies that will not be able to adapt in this new order, increase the risk of disappearing from the market (Ramadani & Hisrich, 2015).

The rapid development of technology and the appearance of internet greatly changed the way of doing business. In simple words, it made electronic commerce possible. Electronic commerce through technology facilitated the connection between manufactures, sellers and buyers like never before. Many companies today use the internet not only as an additional advertising medium or as a marketing tool but as a mechanism of transformation and change of everything when it comes to doing business. These companies discover new innovative ways of using the internet, computers and communication technologies, which improves the relationship with the suppliers and enhances the quality of costumer services. Electronic commerce does not imply complete replacement of the traditional commerce, but represents only an additional way of doing business, leading to the establishment of the overall performance of the companies. Next we are going to distinguish the features of the electronic and traditional commerce. *Traditional commerce* has the following features: marketing and advertisement are done in the traditional way (physical), a provision of standard products and services, delivery of the catalogs (in printed form), communication style is 'one more', the production of the products depends on the supplied products and the existing capacity and the products and the services are offered physically. *Electronic commerce* has the following features: the marketing and advertising it is done through networking and it is interactive, the production of the products and services is based on orders that costumers do, sending electronic catalogs, the communication style is 'more and more', the product production is customized according to the costumers needs and requirements and the products and services offered in substantial quantities are digital (Mamta, 2005).

Electronic commerce affects the growth of various retail product sales. In the United States of America (USA), these figures range from \$1.103 billion in 2011 to \$1.552 billion in 2015 (Fig. 9.2). The Forrester Research Forecasts say that by 2016

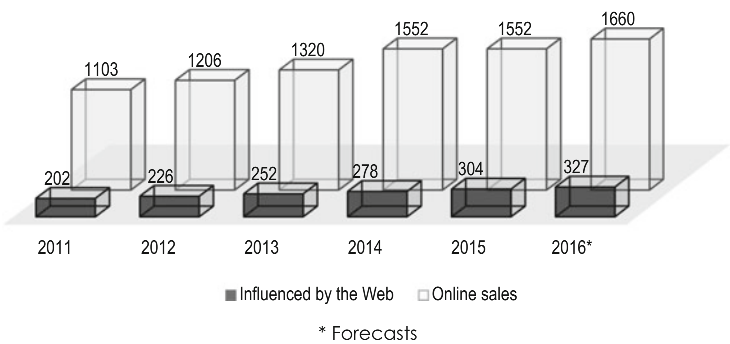

Fig. 9.2 Retail sales through electronic commerce in the US (in billion \$). **Source:** Drawn by the authors based on the data in Forrester (2015). (*asterisk*) Forecasts

sales through electronic commerce will reach $1.660 billion, where over 80% of US households will have regular access to the internet and 50% of them will buy through the internet. Further, according to another study, 72% of companies which have opened their websites, said that since then they have increased their sales and 65% of them have shown that since the application of the electronic commerce they have increased their profits (Clancy, 2011).

According to the Kalakota and Whinston (1997), electronic commerce can be elaborated from several perspectives:

- *Communication perspective*—electronic commerce is distribution of information, products and services, or payment through telephone lines, computer networking and other electronic equipment.
- *Business process perspective*—electronic commerce means application of the technology towards the business transaction automation and work flows.
- *Service perspective*—electronic commerce is a tool that fulfills the wishes of the companies, costumers and the management staff that deals with cost reduction, improvement of service quality and increasing the speed of service delivery
- *Online perspective*—electronic commerce provides the opportunity to purchase products, services and information via internet and other online services.

Electronic commerce presents a contemporary method of doing business, which meets the needs of organizations, sellers, improvement of the quality of products and services and increasing the speed for product and service distribution through the internet (Goel, 2009).

Electronic commerce is defined as marketing, promotion, purchase and sale of products and services electronically, usually via the Internet. Electronic commerce in itself includes (Kuratko & Hodgetts, 2001):

- E-tailing (virtual shop window), which represents the sales site;
- Electronic data exchange (EDI), which represents the exchange of information between businesses;
- E-mail and computer fax;
- Purchase and sale between businesses;
- Providing security of data transactions.

Based on many studies, definitions and explanations, we can say that *electronic commerce (e-commerce)* in itself includes: (1) electronic trading of physical goods and intangibles, such as information; (2) the elements and steps that are involved in the trade, such as online marketing, online payments via internet and the support for the distribution of the products and services; (3) provision of electronic service concerning the support after the purchase or provision of the legal purchases online; and (4) the cooperation between companies, such as manufacturers, suppliers and sellers with the help of modern communication technologies (*see* Ramadani & Hisrich, 2015; Schneider, 2017; Turban, King, Lee, Liang, & Turban, 2015).

Although the benefits of electronic commerce are numerous, still, its use is not widely acceptable by small business owners. The empirical research on 1.427 small businesses show that only 23.06% practice the electronic commerce in their business, which means that nearly 77% of them don't use it at all. Those who use electronic commerce most of the time they only use it to receive and send e-mails, providing information and sharing information and very little buying and selling products and services (Suklev & Ramadani, 2012). According to another empirical research conducted in January–April 2010 in 119 small companies in Macedonia, 42.86% of them do not plan at all to practice the electronic commerce, 26.89% probably will practice it and 30.25% plan to practice the electronic commerce. Of those who plan or probably plan to use electronic commerce, 48.53% of them will do so after 3 years. Other data related to electronic commerce in our country are presented in Table 9.2.

Table 9.2 Electronic commerce issues in small businesses in Macedonia

Issues related to electronic commerce in our country	No. of answers	%
How much do you keep track on the technological developments related to your business?		
Highly	76	63.87
Partly	40	33.61
Not at all	3	2.52
Do you think that the use of IT impact on improving the results in your work?		
Highly	65	54.62
Partly	46	38.66
Not at all	8	6.72
Do you think of accessing to electronic commerce?		
Yes	36	30.25
No	51	42.86
Maybe	32	26.89
If yes or maybe in what period of time:		
Within 1 year	14	20.59
For 2–3 years	21	30.88
More than 3 years	33	48.53
How do you achieve to exchange information with you costumer:		
Direct contact	88	53.01
Telephone	52	31.33
E-mail	17	10.24
Web-site	9	5.42

Source: Authors' field research

9.3 Basic Forms of Electronic Commerce

Electronic commerce can take several form depending on the degree of digitalization, respectively the transformation from physical to digital. The rate of digitization is associated with the sale of the products/services, the process and the distribution agent. So, the product or the service, the process and the distribution agent can be physical or digital. In the traditional trade all these elements are physical and the physically pure companies are known as *brick-and-mortar companies* (with certain local address). In the *pure electronic commerce* these elements are all digital. Other combinations, where are mixed the physical and the digital elements can be called as electronic commerce, but as *partial electronic commerce*. For example, buying a shirt from Wall-Mart online or a book from Amazon.com it is partial electronic commerce, because the product is physically transferred to the client by a carrier, while buying an e-book from Amazon.com or a software by Buy.com it is pure electronic commerce, because the product, its distribution, payment and carrier are online (Turban, Leidner, McLean, & Wetherbe, 2004).

9.4 Electronic Commerce and Electronic Business

In everyday life, people often use electronic commerce (e-commerce) and electronic business (e-business) as one. But in fact these are two very different concepts. *Electronic commerce* refers to the exchange of products, services and information through the internet, or, in the electronic commerce, technology is used for purchase, sale, transfer and distribution of products, services and information, conducting transactions between businesses and also transactions between the business and the consumer. On the other hand, *electronic business* it is a larger concept and in itself includes electronic commerce to. In other words, electronic business does not include only buying and selling products and services, but also servicing consumers, corporation between partners, implementation of e-learning and electronic transactions within the enterprise (Turban, Leidner, McLean, & Wetherbe, 2006). So, here the technology, besides enabling the purchase and sale of the product, it is also used to reinforce the effectiveness and efficiency of the company operation, respectively provides different transactions within the company, such as bills, accounting, management of inventory, provides different services within the company and for partners, developing new products, product distribution, which are mediated through a computer network.

9.5 Types of Electronic Commerce

In literature and business practices we can see some different ways of market transactions realized through the internet. Among the most common ways are the following: Business to Business (B2B), Business to Consumer (B2C), Business to Government (B2G) and Consumer to consumer (C2C). Recently, there can be seen two additional ways: Business to Employee and M (mobile) e-commerce.

B2B e-commerce means trade between businesses, respectively companies, such as trade between a manufacturer and wholesaler or wholesaler to retailer. The statistics say that around 78% of electronic commerce takes place in the form of B2B trade and according to the forecasts of experts in this area, B2B trade will grow with greater speed in the following years (Shaw, Blanning, Strader, & Winston, 2000). According to Goldman Sachs Investment Goldman Sachs Investment Research (1999), B2B commerce consists of two main components, and the 'e-frastracture' (electronic infrastructure) and 'e-market' (electronic market).

"E-frastracture" represents the architecture of B2B, which includes:

- Logistics, which contains transportation, storage and distribution.
- Applications that provide services, which means establishing and managing various software from a central facility.
- Transfer of e-commerce functions to companies specialized in this field (a kind of outsourcing).
- Different software's who manage the auctions that take place via the internet.
- Content management software, which facilitates the management of web contents of a company.
- Facilitators to assist the internet-based sales.

"E-market" represents a website, through which sellers and buyers conduct sales transactions.

B2B e-commerce it is a process, which goes through several stages (Ramadani & Hisrich, 2015):

Phase 1. The company shows interest to engage online in the market, because the company expects it will bring competitive advantage and will attract more. In this phase the company has no access to the internet, does not use e-mails nor does it use its website. The only thing that exists is the interest to engage in the electronic commerce.

Phase 2. The internet starts being used by the company as a tool for marketing and communication. The company creates its own website to attract attention and starts to use the internet as a tool to gather information about the competitors and potential suppliers. E-mail is widely used with business partners, but still there are no sale transactions through the website.

Phase 3. The company starts to use the internet as a tool to manage interactive communication with the consumers. In this phase the company offers some products on the website, but not the possibility to purchase through it.

Phase 4. The company has created the necessary software which provides transactions through the internet. The created links between the company, the storage, producers and the bank, are put in in place to take orders from the consumer and to realize the payment through the internet. In this phase the company creates a good base for making online links between business partners.

Phase 5. In this phase all the links are created and strengthened between the partners, the suppliers and the costumers. In this stage the company can consider itself as a part of the B2B electronic commerce.

B2C e-commerce represents the commerce completed between the company and the consumer, for example buying a pair of shoes from a retailer. B2C commerce has to do with gathering information by consumers, purchasing physical or non-physical products (music, movies or books in the digital format by downloading them from the internet). The most known B2C businesses are Amazon.com, Ebay.com, Aliexpress.com, Beyond.com, etc. The role and the importance of B2C commerce is seen in the reduction of costs related to the implementation of transactions of sale and an easier access to costumers to get information about cheaper prices of products and services that the costumer needs to buy. B2C also has an impact in reducing barriers to penetration of new companies in the market, because the maintenance of creating a website is much cheaper and easier than opening a shop. Also, B2C commerce eliminated the need of having a warehouse in cases where companies deal with non-physical products. The countries where the internet use has increased, and the sales of non-physical products have been profitable. In Europe, the online sales through the B2C electronic commerce recorded value of 325.4 billion in 2013, while they provided that in 2018 they will reach value of $534.9 billion (Statista, 2015a).

C2B e-commerce involves sales transactions in the opposite direction, where now the consumer offers products to businesses. Now the business pays the consumer. A concrete example could be in the case where an author of a book or a singer offers their work, respectively their copyright to several publishing houses or recording labels via the internet.

B2G e-commerce means trading between the businesses and the public sector. B2G has to do with using the internet for declarations and the management of the licensing process, the opening and the implementation of the tender, finding suppliers and other activities for governmental purposes. Obtaining licenses via the Internet increases the transparency and reduce the risk of irregular activities (TA Project, 2010). In the UK, The Trade and Industry Department had planned that 90% of the treadmill supplies to be made electronically (Tassabehji, 2005). B2G as an electronic commerce component, compared to other models, it is still in the development stage and has no significant role in the overall electronic commerce.

C2C e-commerce it is a trade between private individuals through a third intermediary. The third intermediary (which usually is a website to link the buyers and the sellers) for the finished services it receives an allowance or a provision from the sale transaction. In UK, in 2014, 37% of the population used this form for selling or purchasing products/services (Statista, 2015b). This kind of trade is presented in three forms (Turban, Leidner, McLean, & Wetherbe, 2008):

- Auctions located on portals such as eBay, allow to bid for products sold on-line.

- The system peer-to-peer, such as Napster model (protocol for file sharing between users used by members of the chat-forums) or other models of sharing files.
- Advertising or Classified Ads placed in different portals that resemble electronic markets, where sellers and buyers can negotiate for products and prices.

B2E e-commerce includes activities that take place within the, respectively between the company and its employees, between units within the company or between the employees in the same company. B2E can include: training and education for the employees through the internet, ensuring the needed work-materials, purchasing insurance for the employees, travelling packages with a cheaper price, purchasing products from the company with a discount, etc. (Saini, Saini, & Gupta, 2009).

M-commerce it is the selling and buying method through mobile device, for example, mobile phones, tablets and laptops, which nowadays without any difficulty can connect to the internet through the wireless systems and perform transactions. The use of the m-commerce is growing more and more through the years (Fig. 9.3) and slowly is transforming into a relevant component of the economic development, where according to a study, in Europe through this form of electronic commerce is expected to be achieved an annual revenue of 23 billion €, while companies invest 200 billion € in equipment and training to enable the costumers the use of m-commerce (Department of Justice, 2002). eMarketer (2010) predicted that in 2016, the sales through the m-commerce will reach $149.79 billion, which would represent 28% of the total retail sales through the internet. At the global level, at the end of 2015, through the m-commerce were expected 490.1 billion $ sales (Zeendo Blog, 2013).

M-electronic commerce is mostly used in these areas: *Financial services*—nowadays individuals and companies can pay their bills by logging in in their bank accounts through their mobile phones. Thanks to the technology developments and m-commerce, today the sale and purchase of shares in stock exchange can be done from the mobile phone; *telecommunication*, the potential of a

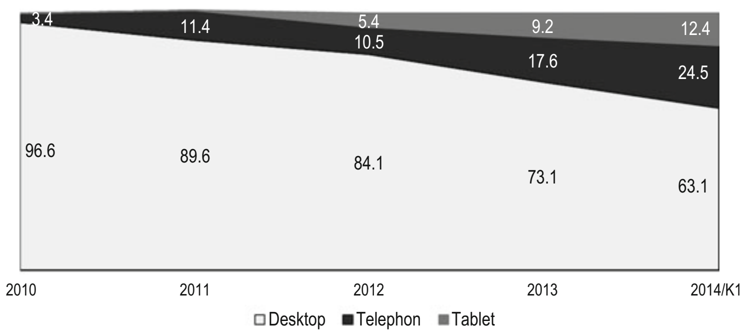

Fig. 9.3 The participation percentage of m-commerce in total electronic commerce (retail). **Source:** Drawn by the authors based on the data in The Custora E-Commerce Pulse (2014)

mobile phone today can be compared to a computer and almost all transactions performed by the computer can perform by a mobile phone too; *the service and trade industry*—the technology development today allow us to perform offers or payments while walking down the street or while sitting in a coffee-shop or your backyard; and *information services*—include sending information directly to mobile phones about sports results, events in the sphere of show-business, road conditions and weather forecasts (Andam, 2003; Ratten, 2008).

9.6 Impact of Electronic Commerce in Business

The impact of electronic commerce in the operation of a small business can be seen in some areas, such are (Mamta, 2005):

1. **Direct marketing**. Direct marketing has traditionally been accomplished through the distribution of catalogs or telemarketing. With the development of the Internet, direct marketing via the internet grew a lot. Among the main effects of electronic commerce in direct marketing are:
   - *Promoting products:* Electronic commerce adds to the ways of advertising products through direct and interactive contacts with customers. So the, the Internet enables advertising direct (one-to-one) and is much more effective than traditional advertising. Spending on advertisement through the internet is continuously increasing, which is observed at Fig. 9.4.
   - *New sales channels*: the Internet enables businesses creating new sales channels and faster integration in the global market;
   - *Direct savings*: electronic commerce enables businesses preservation and exchange of information through the data warehouses, where businesses save more by not using the documents, letters and archives. Also, many products (songs, movies, software) can be digitized and electronically distributed to a much cheaper price compared with physical delivery;

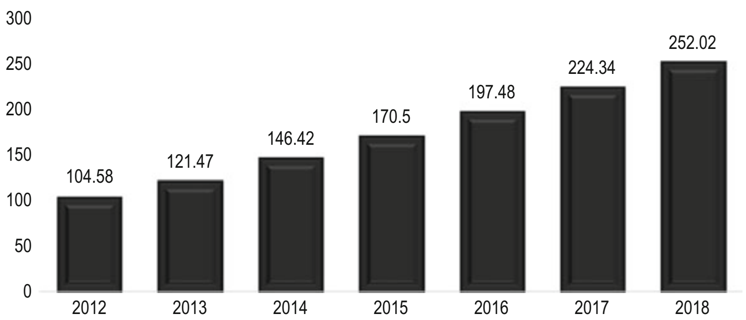

Fig. 9.4 Online advertising costs on a worldwide level 2012–2018 (in billion $). **Source:** Drawn by the authors based on the data in Statista (2015b)

- *Cycle time reduction:* distribution of digitized products and services can be done in a few seconds.
- *Services for customers:* Customers are allowed access to any information by connecting to the network. For example, well-known American company Fed-Ex enables its customers to monitor the transfer of their products and their status on what condition and place is the product at a certain time. They also provide answering the customers question in an interactive way;
- *The company's image:* electronic commerce allows companies to change their image in a short period of time. For example, *Amazon.com* managed to create its image on the web for three years. Also, the other companies like Dell, Cisco, Intel etc., focus on the web activities to affirm its identity and image.
- *Product adaptation:* Electronic commerce provides the production of the products depending on the customers' requirements and budget. So that customers can more quickly and easily find products that suit their style and budget.

2. **Organizational structure**. The incredibly fast development of electronic commerce will push businesses to use new technologies, create new business structures, redefine the organizational structures and change their products. The impact of electronic commerce to organizations is associated with:
   - *Technology and organizational learning*. Companies that produce products and communicate with customers in the old fashioned ways must provide new technologies for production and communication as fast as they can if they want to survive in the new world of e-business.
   - *Changes in organizational culture*. The high level of adoption and use of electronic commerce by businesses will cause drastic changes in the work culture and employment. As part of organizational learning, companies are obliged to extensively begin to train their employees or to operate with workers who previously have experience in digital period. As companies are supplied with EDI (electronic data interchange) and EFT (electronic fund transfer) applications of electronic commerce, is necessary to reduce the number of employees in the company. This phenomenon has already begun to happen. Another strategy that can be observed among the todays' companies, is cost reduction, however this can be seen as a threat for the employees, the relocation of companies in countries where wages are lower. This leads workers and companies to change their beliefs about jobs, careers and salaries.

3. **Production.** Introduction and development of electronic commerce affects the production process, respectively changes the production from massive to demand-oriented, known as just in time production, which reduces inventory costs, 50% production cycle, especially when customers and designers are from different countries

4. **Accounting and finances**. Electronic commerce requires special accounting and financial systems, in order to facilitate the work of companies during the process of evaluation and decision-making process. The debit/credit cards, electronic cash (e-cash) and electronic cheques (e-cheques) are one of the systems through which electronic payments are done. With these systems even though it seems complicated, they have revolutionized the field of payments.
5. **Human resources management**. Electronic commerce has had a great impact on the development of methods and techniques of training and education of human resources. For example, distance learning, day by day becomes more popular and creates opportunities for education, unpredicted until now, as a provision of communications via so called two-way video, interactive systems of providing instructions from a distance and a common use of information. As an example regarding in this case, we can mention the case of the Hong Kong University, which offers interactive MBA studies and the Old Dominion University in Virginia, which through the satellite system links its university with 23 other universities and with the governments' websites and other industries. Companies agree with the idea that distance learning, applications and virtual courses are the key of surviving in this dynamic world of business and through these they reduce their costs for training and the education of human resources up to 50%.

9.7 Benifits from Electronic Commerce

Small businesses can get involved in electronic commerce for various reasons. The main reason why these businesses enter electronic commerce is attracting new customers. This backed up by the answers of 78% of the respondents. Than we have the sale of products and services with 65%, the more efficient distribution of information with 62%, keeping pace with the competition 23%, the global expansion with 17% and the creation of perspectives for the employees. This can be seen in Fig. 9.5.

Some of the main benefits from electronic commerce for companies are as follows (Scarborough, 2012):

- *Opportunity to increase revenues*. Opening of a website from a small business and entering in the electronic commerce means opening a new sales channel. This enables the total increase of the company sales. The online sales of the Domino's pizzeria represent 25% of total sales, while in the day of the "Super Bowl Sunday", which marks the end of the American Football Championship and determines the league champion, Domino's got more than 160,000 online orders, and more than 1000 clients are ordering in a minute before the game starts. Pizza Hut another well-known pizzeria, generates $2 billion annual sales through the internet.
- *Opportunity of expansion in the global market*. Web and electronic commerce represent the most efficient way by which small businesses can sell their

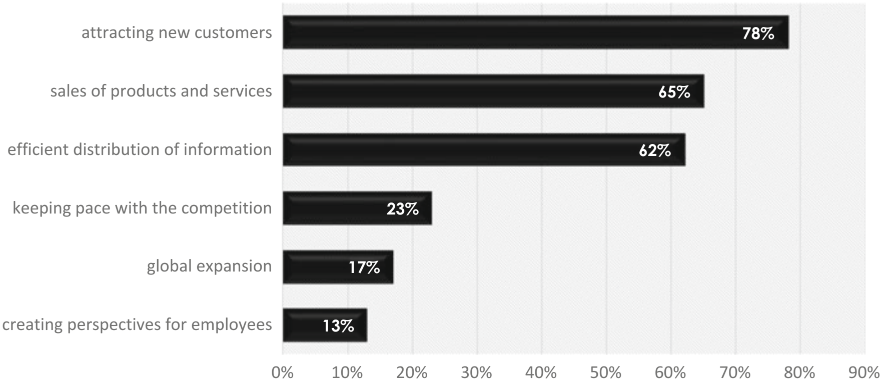

Fig. 9.5 Reasons why companies enter the electronic commerce. **Source:** Drawn by the authors based on the information in Raskin (1999, p. 20)

products and services outside the country. The entry into the global market through traditional methods is expensive and difficult, especially for small businesses.

- *Opportunity to work 24 h a day, seven days a week.* Electronic commerce enables small businesses to work uninterrupted 24/7, without additional expenses in connection with the commitment to the sales personnel. Consumers should not be thinking about the hour or asking 'is the shop still opened'?!
- *Opportunities to lower costs for doing business.* Web and e-commerce is the best way to approach new customers and current. Web also reduces costs for sales, customer support, distribution of marketing materials, inventory costs by reducing the sales cycle.
- *Opportunities for a faster growth.* Web and e-commerce create greater opportunities for growth. Companies that use the internet (electronic commerce) achieve greater growth by 46% compared to those companies that do not use it.
- *Opportunity to track the results of sales.* Web enables the small company to pursue any activity that occurs on the website, including the number of visitors in general and those for a given moment. Through the web the business owner can monitor sales and in the impact of electronic commerce.
- *Opportunities for identifying new business opportunities.* It enables the connection to receive more information about customers and their needs and desires. They find it easy to write an e-mail for any of their needs than to visit the store. Therefore, with increasing customer submission of applications it may leave some interesting ideas for the delivery of new products or services in the future. Regarding this issue, interesting issues are treated in Etemad, Wilkinson, and Dana (2010) as well.

Companies that provide electronic commerce provide several benefits, including: reduction of time for supply (13.3% of answers), improved communication and relations with suppliers (13.3%), improved communication and relations with customers (12.6%), security and greater control of orders (11.9%), new marketing and sales channels from global aspect (10.4%), reduction of costs and inventory levels (8.9%), elimination or reduction of intermediaries (8.9%), reduction of the purchase price (7.4%) etc. (Radovilsky, 2009).

9.8 Barriers to Implementing Electronic Commerce

Despite the many benefits of electronic commerce for small business, consumers and society, however, there are some barriers, which the owner of a small business should consider. The most common barrier to implementation of e-commerce are (Turban et al., 2004):

- *Managing the resistance toward changes*. With the implementation of electronic commerce the way of doing business changes, so it can display resistance to these changes by the employees, managers, suppliers and customers. As a solution to overcome these barriers there should be training for a certain time for all the stakeholders above.
- *Integration of e-commerce in business environment*. Electronic commerce must be integrated with the rest of the business, respectively the planning, competition with other projects for using resources of the company, providing the databases equipment, existing applications and infrastructure.
- *Lack of qualified staff and usage of external management*. A small number of people are familiar with the operations of electronic commerce, considering this for some of its activities the company is forced to hire a management from outside.
- *Design of an adequate plan for implementation*. The plan for the implementation of electronic commerce, as well as all other plans must include goals, policies, the needed financial resources, time frame and an emergency plan. The dilemma arises, how much do all these elements comply with the company's general plan?!
- *Justifying e-commerce implementation*. Through the use of cost-benefit method it can hardly be justified the implementation of electronic commerce, because there are some benefits that cannot be easily measured and are not precise

Overcoming these barriers on the implementation of electronic commerce is not a short-term and a simple process. This depends a lot on the economic level of the company, because the societies that have a better economic development embrace new trends more easily, and they familiarize themselves faster with the new ways of operating, compared to those less developed.

9.9 Summary

This chapter treated electronic commerce as a new way of doing business. Today, customers spent a lot of time in internet and this represents a great opportunity for companies to increase their profits and sales. Here were discussed the most common forms of electronic commerce, such are: Business to Business (B2B), Business to Consumer (B2C), Business to Government (B2G) and Consumer to consumer (C2C), Business to Employee and M (mobile) e-commerce. Chapter ends with benefits from electronic commerce and the barriers for its implementation in the companies.

Case Study: LatestinBeauty.com—Increase Online Sales Without Discounted Prices

LatestinBeauty.com online is a British company, which offers a wide assortment of products for beauty from Prestigious brands such as Clinique, Bourjois and Liz Earle. LatestinBeauty.com except that offers sets (boxes) brand standard, it offers the possibility to create its customer favorite kit (box), combining products from different brands, therefore, the customers' needs and desires. The website had created a partnership with a technology company for retail promotions, Luckycycle.

LatestinBeauty.com held a promotional event during the Easter weekend, which included all its assortment, providing customers who have spent over £ 10 to win the opportunity to purchase for free, while unlikely the opportunity to win was '1 in 10'. This campaign was labeled as 'Lucky Egg', while buyers could use this option only after having completed the purchase 10 + £.

Fiona Dillon, manager for electronic commerce and social media in LatestinBeauty.com, she commented on the campaign that: "Discounts have become the standard procedure for rewarding customers—we wanted to offer something that people wouldn't necessarily expect . . . Luckycycle gave us the chance to stand out in a fresh way that leaves a lasting impression. Making sure the retail experience is notable is essential to captivating our audience, and the gamification element added a level of fun and intrigue. It's something you'd want to share, and something that people want to talk about."

The results from this campaign showed us that the average number of orders rose for 21% during the four-day holiday and that LatestinBeauty.com plans to use Luckycycle in the further campaigns.

"LatestinBeauty.com understands the need for the development of its offers," says Géraud de Borchgrave, the Luckycycle manager. "We are moving away from a system of coded coupons, where the majority of promotions today are focused. . .the organization of a different kind of campaigns reflects LatestinBeauty.com as a dedicated and personalized approach to the customers shopping experience." So Luckycycle enabled LatestinBeauty.com to increase sales without lowering prices of products.

(continued)

Questions

- How do you assess LatestinBeauty.com policy to attract customers?
- What would you recommend something different for this company to increase its sales?
- Do you agree that discounts represent the best policy for attracting customers?
- Visit the website of LatestinBeauty.com and what changes will you recommend them?

Source: This case is written from the authors based on information in: https://www.latestinbeauty.com; http://www.digitaltrainingacademy.com/casestudies/2015/06/ecommerce_case_study_luxury_beauty_site_boosts_sales_by_third_with_lucky_egg.php (Accessed: May 06, 2016)

Questions for Discussion

- What do we understand with e-commerce?
- What is the difference between pure electronic commerce and the partially electronic commerce?
- What is the difference between electronic commerce and electronic business?
- Clarify B2B electronic commerce and present it graphically!
- Clarify B2C electronic commerce and present it graphically!
- What is the M-commerce?
- In what areas we see the impact of electronic commerce?
- Explain the impact of electronic commerce on direct marketing!
- Explain the impact of electronic commerce in the organizational structure!
- What is the impact of electronic commerce in finance and accounting?
- What is the impact of electronic commerce in the field of human resources?
- What are the barriers to the implementation of electronic commerce?

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Business Ethics, Social Responsibility and Entrepreneurial Managers

10

Learning Objectives
After reading this chapter, you should be able to:

- Define ethics and business ethics
- To understand situations with an ethical dilemma
- To explain the model of the ethical behavior
- To know the development levels of the ethical values
- To make distinctions between amoral, immoral and moral managers.
- To understand the essence of social responsibility
- To describe the pyramid of social responsibility
- To know the benefits of being a social responsible enterprise

Profile: Aaron Feuerstein—Malden MillS

Aaron Feurestein (the old), a Hungarian immigrant in 1906 bought the company Malden Knitting in Malden, Massachusetts, USA, which was producing wool sweaters and swimsuits. On December 11, 1995 while Aaron Feurestein Jr., the third-generation owner and CEO of Malden Mills, was celebrating his 70th birthday in Boston, this factory was gutted by a fire, which was considered as one of the biggest fires in the history of New England, by causing a $400 million damage. This caused the closure of the factory for a period of several months. This means that the workers had to be fired, and remain with no incomes. However, the owner Malden Mills did not think so. He decided to rebuild the factory and continued to pay more than 3000 workers for 6 months until the factory was rebuilt. The amount of the paid salaries, for which the workers did no work, was about $25 million. This

(continued)

R.D. Hisrich, V. Ramadani, *Effective Entrepreneurial Management*, Springer Texts in Business and Economics, DOI 10.1007/978-3-319-50467-4_10

decision would cost him his $300 million insurance settlement and an additional loan of $100 million.

For some people he was a saint, for some others, a fool. The newspapers, the magazines and TV stations in the whole country presented him as a hero. Bill Clinton, the president of US at that time, invited him in a meeting at the White House in Washington. The columnists, the different union, the religious leaders highly appreciated his work, his care for his workers without any personal interest. Some others noted that he had acted irrationally. He should have taken the money from the insurance, and close the business. On the other hand, if he would want to continue with his business, he could dislocate it in another place where the operation costs lower. A normal entrepreneur would not spend so much money with no reason. Some professors have told their students that Mr. Feurestein should not be seen as a model. Feuerstein disagreed and said: “I think it was a wise business decision, but that isn’t why I did it. I did it because it was the right thing to do.”, in an interview with 60 Minutes in CBS News.

This decision of Feurestein remained a topic for debate for a long time. The main question was: Why Mr. Feurestein spent $25 million to more than 3000 workers while it was needless, and would not be done or suggested by any normal entrepreneur?! Mr. Feurestein, early in his career, had seen many closed companies in New England, which had moved to south, where the operation costs were lower. Many of these companies had failed, as Mr. Feurestein believed, as a result that they had been more focused on costs than on quality. The low costs create advantage in short term, while quality creates advantages in long term. People are the main factor in creating long quality. Mr. Feurestein wanted skilled and devoted workers, not ‘cheap’ workers. According to the ‘Fortune’ magazine, many idiots run after a quick profit, by ‘milking’ the customers, by mistreating the workers, and by abusing the company’s image. In order to make long-term profits, you should create values through ‘superior’ workers. In 1996, he stated for Parade Magazine that: “I have a responsibility to the worker, both blue-collar and white-collar. I have an equal responsibility to the community. It would have been unconscionable to put 3000 people on the streets and deliver a deathblow to the cities of Lawrence and Methuen. Maybe on paper our company is worthless to Wall Street, but I can tell you it’s worth more.” Aaron Feurestein and his company Malden Mills, had very loyal customers and workers. He knew that to walk out from the crisis as result or fire, the only way was through loyal, motivated and devoted workers in their duties. Simply, he took a genius decision. On March 13, 1998, Aaron Feurestein, for setting the standard for commitment to employees, was awarded the *Peace Abbey Courage of Conscience Award*.

Source: This profile is written from the authors based on information in: Nixon (2014) and Teal (1996)

10.1 Introduction

Did Aaron Feuerstein inspire you? Bruce Kroll certainly, yes! He had the same fate like Aaron Feurestein, where the fire destroyed his newly remodeled Culver's restaurant, located in Platteville, Wisconsin, on the night of November 13, 2013. His 40 workers feared the loss of the workplace. But, the owner, Bruce Kroll reduced their fears and told them that they will be paid for 6 months, until the restaurant will be rebuilt and reopened. Two months were paid from the insurance and the remaining four, about $144,000, out the Kroll's own pocket. Kroll asked them to perform some kind of community service throughout the rebuilding process of the restaurant, where one did a fundraiser for the fire department, some worked in food cold-rooms, some others helped churches to organize the Christmas dinners and some others worked as babysitters, free of charge, for people who needed daycare (Entrepreneur, 2015).

In this chapter, we will focus on ethical values, standards and beliefs and their implementation in business. Will be discussed the situations with ethical dilemma and how to deal with them. In addition, will be treated the factors that affect an ethical behavior and will be explained the features of moral, amoral and immoral managers. The chapter ends with the discussion of the essence of social responsibility, the pyramid of social responsibility and benefits from action as a socially responsible business.

10.2 Ethics and Entrepreneurial Managers

Business ethics recently represents a very prominent topic, and debates about it have attracted a great attention in various circles. Customers and different groups are increasingly requiring from the companies to be more ethical and be more responsible about social issues. Media, also continuously is keeping in the spotlight the abuses and the misusing of the corporations. Even the companies itself have started to conclude that being ethical (or at least looking like as ethical) can bring additional benefits for the business. Therefore, there are many reasons why ethics can be considered as an increasingly important study field, for the students interested in evaluating the business activities, or for the managers who seek to improve their decision-making skills (Crane & Matten, 2007).

Ethics includes values, standards and principles that show what is right and what is wrong, while *business ethics* can be defined as the application of moral principles and standards in the business policies, behavior and institutions. According to Fieser (2010), when business people talk about business ethics, they think about one of these three things: (1) avoiding from violation the law in their business activities, (2) avoiding activities that can result with charges against the company, and (3) avoiding activities that can harm the company's image.

Ethics could be better understood when are compared the behaviors that are ruled by law and by free choice (by will). The Fig. 10.1 illustrated that the people's

Fig. 10.1 Categories of human behavior. **Source**: Based on Daft, Kendrick, and Vershinina (2010, p. 165)

behavior can be divided in three categories. The *codified laws*, where values and standards are written in a law system and are obligatory, make the first category. In this category, the lawmaker has determined a path, which should be followed by the individuals and companies. For example, if you want to drive the car and not be fined by the police officer, you should have your driving license and maintain the prescribed speed; or if you have realized profit, the law strictly says that you should pay taxes to the government for this profit. The category of *the free choice* is at the opposite side of this figure. It has to do with behaviors that are completely under individual's authority and law cannot interfere them. The decision of a manager in which restaurant he will have a lunch; or the decision of a publishing house, how many books and in what format will publish, are examples of the free choice. Between these two categories lies the ethic's category. *Ethics* does not contain specific laws, but has behavior standards that are based on principles and values, by which can be guided an individual or a company. For example, the management of *Enron* did not break any specific law, when encouraged its workers to buy shares, even they knew that the company has serious financial problems, and the price of the shares will son decrease at the stock market. However, this behavior of the management violated the ethical responsibility that has towards its workers. In this case, the management was more driven by their personal interests then by the care that should have towards its workers. Since ethics is between law and free choice, an ethical decision can be considered the decision that is legally and morally accepted by the wide society (see Daft, 2015).

We mentioned above that ethics is based in standards. The ethical standards can be of different types. Generally, there are three standards' types: *conventional, teleological, and deontological.*

The Conventional Standards These standards are based on the moral philosophy, known as *ethical relativism*. According the ethical relativism, it depends on the moral norms of the society if an action is right or wrong. A same action can be morally right in one society, and morally wrong in another one. For the ethical relativists there are no universal moral standards, standards that can be applied by all people at the same time (Velasquez, Andre, Shanks, & Meyer, 2010). The traditional standards are defined as accepted norms by organizations, the industry, professionals and society, as necessary for the better functioning of the businesses (Schwartz & Carroll, 2003). The society represents the personification of the company's stakeholders like shareholders, employees, customers, competitors, suppliers etc.

Teleological Standards The term 'teleology' comes from the Greek word *telos* that means 'end' and *logos* that means 'science'. These standards are focused on results, respectively in effects. As results can be counted everything that an individual wish, like pleasure, professional development, money, knowledge, or any other interest. Teleology includes also *egoism* and *utilitarianism*. Egoism foresees the incensement of goods only for ourselves, while utilitarianism foresees the increasing of goods for the entire society. According to teleology, a certain action is considered ethical if it improves and increases the goods for the society, in which the individual belongs (Velasquez, 2002).

Deontological Standards The term 'deontology' comes from the Greek word *deon,* which means 'task'. According to deontology, some moral standards are obligatory, regardless the consequences. The deontological standards are focused on tasks and rules. According to deontology, in order to be ethical, we have to understand what our tasks are, and what rules exist on performing these tasks. Everyone conducting his own tasks, is behaving ethically, and vice versa, everyone who is not conducting his tasks we cannot say that he has ethical behavior. If a task is performed in accordance with the foreseen rules, even it may end with dire consequences, is treated as ethical. Therefore, it is important to perform the task within the rules, and the consequences that arise from that task are not important.

10.2.1 Ethical Dilemmas

Regarding the fact that ethical standards are not codified as laws, always exist disputes and dilemmas about ethical and proper behavior. Ethics usually has to deal with decisions and actions that should be taken, and issues that are hard to be solved—decisions, actions and issues where will be displayed the so-called ethical dilemmas. *Ethical dilemmas* display in the situations where it is hard to distinguish well from evil, right from wrong, or they display in situations in which values are in conflict. Here are presented some examples of ethical dilemma:

- The sales manager had come in the morning at the company's accountant office, with whom were also good friend, and had brought a bill about a dinner that he had in a luxury restaurant in Skopje, Macedonia. He had said to the accountant to pay that bill, because last night he had had dinner with a business partner from abroad, with whom the company will sign a very good contract. The accountant gave the order for payment, and came to the sales manager's office to tell him the payment was done. The office's door was open, and he unintentionally heard a conversation between the sales manager and his mother how they were telling each other how well they had spent last night at the restaurant while celebrating her 65th birthday. The accountant realized that the sales managers had not been in a dinner with a business partner, but he had been with his family. But, because he had already paid the bill, and to not ruin the long friendship with the sales manager, he didn't tell anyone about this (Ramadani & Hisrich, 2015).

- The marketing managers has received a task to organize an aggressive promotional campaign about a medicine that cost $2500 for a single dose. The marketing manager had realized from the R&D department that this medicine had only 1% more effect that the existing alternative medicines that cost only $625 for a single dose. In front of the marketing manager appeared the dilemma whether he should now aggressively promote the medicine to attract patients to by this medicine, although there was present in the market a cheaper alternative?! He was wondering, if he will not promote this product and maybe many people would die, exactly because of that extra 1% of effectivity that this medicine possesses. He decided to promote it (Daft, 2010).
- It was the September exam session. It is exam session where many students depend if they will continue the next academic year. Rrezon had enrolled the exam in 'Entrepreneurship and small business', and had scored 49 points, but the minimum score to pass the exam was 51 points. This meant that he would not pass the exam successfully. Rrezon was coming from a family with bad economic condition, and was studying in a university thanks to a scholarship from a foreign foundation. If he did not pass the exam, he had to pay an extra amount of 900 Euro to re-register the academic year, amount that for sure would not have been covered by the scholarship. He told his situation to his professor, and the professor affected by this situation, broke his and University's rules and principles, and allowed Rrezon to pass the exam.

According to Blanchard and Peale (1988), there are three questions that one should address himself every time he faces with an ethical dilemma:

- *Is it legal?* In other words, am I violating any company's law or policy? If you are considering any marketing secret, product design, hiring or firing employees, a way of eliminating waste, etc., it is necessary to think about the legal implications about these issues.
- *Is it balanced?* Am I acting appropriately? Would I like to be treated this way? Is this right for all stakeholders both in short term, but also in long term? Is this a favorable situation for those who are directly involved, as well as for those indirectly involved? In a company, it is impossible everything to be in a balance, but there have to be made maximal efforts to avoid misbalanced situations, where one party every time or in most situations feels damages, while the other party feels favored. In other words, we have to make decisions where the most of the involved parties will feel favored.

- *How will we feel from our own decisions?* Will I be proud of my own decision? Will I be proud if my family understands my decision? Will I be able to discuss the proposed situation with my direct supervisor? How will the clients feel? Are we proud with ourselves if we take this decision? Would we like the others to know that we had taken this decision?, and so on.

10.2.2 Model of Ethical Behavior

The ethical or non-ethical behavior is a complex combination of several factors (Fig. 10.2). At the center of the model is the *individual*, who decides about his behavior. He presents a unique combination of features, personal moral values and principles, which lead him to behave ethically or non-ethically. Personal experiences in getting rewards and promotion, on one hand and punishments, on the other hand, for specific behaviors have important impact in his behavior. As well as the gender has important role in the individual's behavior.

On the ethical behavior, despite individual's factors can also affect three other groups of factors, such as: *cultural, organizational,* and *external factors.*

Culture plays a crucial role in influencing the individual, respectively on his ethical and non-ethical behavior. Individuals that have a healthy family, live together with both parents, are well educated, and those who base their behavior on religious principles are more ethical in comparison with individuals that live with divorced parents, are not educated, and do not adhere to religious principles.

Organization represents an important source of impacts on the individual and his ethical or non-ethical behavior. The activities and decisions of an individual within a company are observed by the manager, and based on it, the individual will be rewarded or punished. Relevant impact in creating a climate for ethical behavior

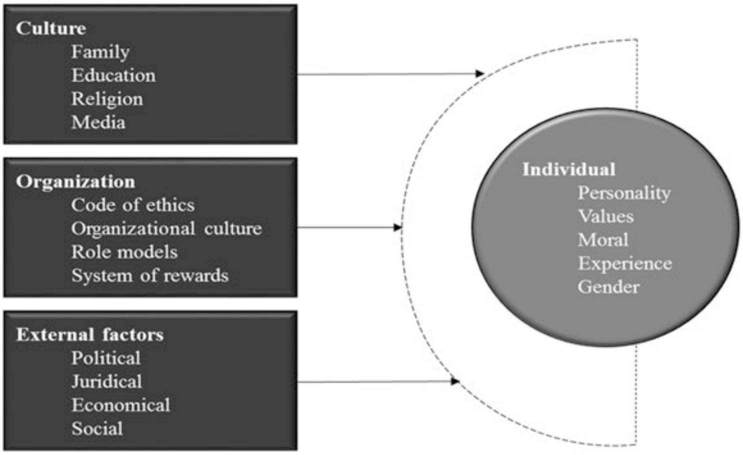

Fig. 10.2 The model of ethical behavior. **Source**: Based on Kinicki and Kreitner (2003, p. 39)

Table 10.1 Factors that influence the ethics of small businesses' owners

Factors	Number of answers	Percentage (%)
Norms and pressures from the society	21	16.94
Moral and religious beliefs	61	49.19
Expectations for additional benefits	16	12.90
Gaining publicity in the society	15	12.10
Fear of punishment form the state institutions	3	2.42
Other	8	6.45
Total	124	100.00

Source: Authors' research

have the company's formal written policies (code of ethics), the behavior of the general manager or of the owner, the company's organizational culture, the pressure on the employees in achieving results, etc.

External factors (*political, legal and economic)* also play a respectable role, and have big impact on the ethical or non-ethical behavior of the individual, because the individual and the company act in an external environment. This environment is consisted of other individuals, various competitors, numerous legal rules and laws, etc. For example, if the government bodies do not react against the non-ethical behaviors of the individuals and companies, then the individual or the company may be tended to act in a non-ethical manner, and vice versa.

Empirical data (Table 10.1), from a survey with 119 small businesses' owners in Macedonia, show that the most important factor that influence on an ethical behavior of the entrepreneurial managers are their moral and religious beliefs. Then, follows the norms and pressure of the society (17% of the answers), the expectations for additional benefits (13%), gaining of publicity in the society (12%), the fear of punishment from the governmental institutions (2%), and other factors (6%).

10.2.3 Development of Ethical Values

As noted in the previous section, the individual's behavior can be affected by numerous factors, as personal needs, family, religion, organization, external factors etc., who in any way can form the value system of an individual or a manager of a company. Related to this, of crucial importance is the treatment of the different levels of the ethical values, which are presented in Fig. 10.3.

Pre-conventional Level In this level, people respect the rules by having fear of punishment. Therefore, they behave properly, to not be punished. People at this level do not pay too much attention to other people needs and desires. They only wish to fulfill their needs. In the business context, they perform the specific tasks and goals, set by the management, having fear of being punished if they do not realize them.

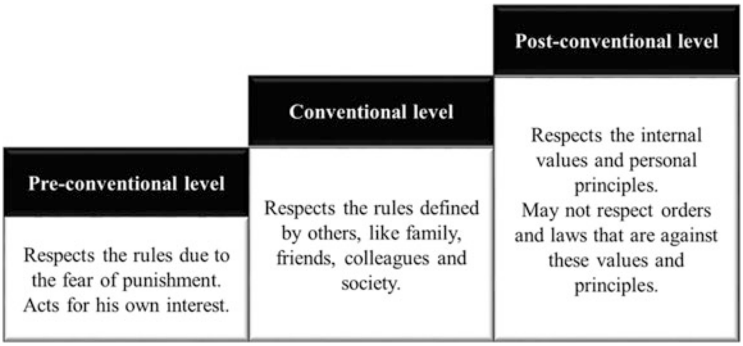

Fig. 10.3 Levels of development of ethical values. **Source**: Based on Kohlberg (1976, pp. 173–205)

Conventional Level People in this level respect the principles and rules, which are defined and acceptable by family, friends, colleagues and the society. The fulfillment of the social and interpersonal obligations is of great importance. Working in groups is preferable in performing the company's goals. The managers uses a management style that encourages the interpersonal relations and cooperation.

Post-conventional Level In this level, a group of their own internal values and principles leads people. They are ready not to do the works or respect the rules and the regulations that are against their own principles. The internal values are more important that the expectations from the others. The managers and employees that have reached this level, act ethically in any case, regardless the consequences that may arise from their actions.

10.3 Ethical Behavior Approaches

There are several approaches regarding the clarification of the ethical behavior of an individual or a company. Among the most important are the utilitarian, the individualism, the moral rights and the justice approach (Daft, 2015; Daft, Kendrick, & Vershinina, 2010).

Utilitarian Approach This approach is based on the lectures of the philosophers Jeremy Bentham and John S. Mill. The goal of this approach is to produce as more goods for as more people. According to this approach, every decision-maker, who has several alternative decisions, should chose that one that brings benefits or pleasure for a larger number of people. However, during the decision making process are taken into consideration only people that are affected directly by a decision, and not they who can be indirectly affected.

Individualism Approach According to this approach, an ethical decision is the decision that fulfills and protects the long-term interests of an individual. The one valuate the long-term expectations in accordance with the goods that can be generated through this decision.

Moral Rights Approach This approach states that every individual has his own fundamental rights and freedoms that cannot be infringed by any individual decision. There are six fundamental rights, which should be taken into consideration during the decision making process. These fundamental rights are:

- *The consent right*. Individuals should be treated only as they prefer to be treated;
- *The intimacy right*. Individuals should choose on their own how to behave out of the working hours, and to have control on information regarding their private life;
- *The conscience right*. Individuals may refuse to perform their tasks which are against their moral and religious norms;
- *The free speech right*. Individuals may strongly criticize the actions of others without being afraid of retaliation;
- *The right to an adequate process*. Individuals have the right for fair investigation and correct treatment;
- *The right of life, and security*. Individuals have the right to live the life without threats, and dangers against their health, and security.

Ethical decision-making means to make decision without violating the individuals' fundamental rights. For example, the decision to watch the employees violated their intimacy right, their privacy, or the sexual harassment in the workplace violates the employee's consent right.

Justice Approach Under this approach, the ethical decision must be based on equality, justice, and impartially standards. There are three types of justice, which a manager should consider: distributive justice, procedural justice, and compensation justice. *The distributive justice* requires that individuals who have equal characteristics (knowledge, skills, and abilities) and commitment to be treated equally. For example, male and female employees cannot receive different salaries if they do the same work. They should be paid equally regardless that are of different genders. *The procedural justice* foresees that rules should be equally administrated, and be applied equally by everyone. They should be clearly defined and applied by everyone, regardless their current position in a company. *The compensatory justice* foresees compensation for damages to individuals that can happen because of an irresponsibility of any party. In addition, an individual should not be charged for things that are out of his control, for example, if the shop burns due to improperly electric installation, or due to lightning; there should not be asked to compensate the damage the worker, who has been in his worktime during the accident.

10.4 Business Ethics and Entrepreneurial Management

Refereeing to the approach that, in many cases, ethics and moral are used as synonyms, we can say that there are three entrepreneurial manager types: immoral managers, amoral managers, and moral managers [Based on Carroll (1991) and Carroll and Buchholtz (2015)].

10.4.1 Immoral Entrepreneurial Managers

Immoral entrepreneurial managers are considered those whose decisions, actions, and behavior are against to what is considered right or ethical. These decisions and behavior are against the ethical standards. Although they know what is wrong and what is right, they decide for the wrong one. According to these entrepreneurial managers, they should only care about their personal and organization incomes, or with simpler words, their only goal is to realize profit for the organization and individual success. The immoral entrepreneurial managers see laws as barriers, which must be overcome in order to complete their goals. As an example of immoral entrepreneurial manager, often is mentioned the case of the Lincoln Savings & Loan manager, Charles Keating, who by misusing his position and some accounting tricks, led the company in bankruptcy while 'robbing' $34 million for himself and his family.

The orientation of this type of entrepreneurial managers toward different stakeholders is as follows:

- *The orientation toward the shareholders*. Under this type of management, the shareholders are treated only a little, or are not treated at all. The managers' focus is in maximizing their own compensations and benefits. 'Golden parachutes' are more important than paying dividends to shareholders. Managers reinforce their positions, while the shareholders are not aware of that. Many operative actions are done behind the shareholders' back; the shareholder are not informed almost for anything. The main goal is to fulfill the management's needs and desires.
- *The orientation toward the employees*. Employees are considered as a production factor, which have to be used, exploited, and manipulated to create benefits for the managers and the organization. There is shown no care about the employees regarding their needs, rights, and expectations. Tony Rohr, a former manager at Pizza Hut, was fired from his job for refusing to work on Thanksgiving Day. Thanksgiving and Christmas Day were the only two days that they were closed and the employees want to spend them with their families. His

supervisors asked him to sign a letter of resignation, but Tony Rohr in that letter wrote: “I am not quitting. I do not resign however I accept that the refusal to comply with this greedy, immoral request means the end of my tenure with this company. . .I hope you realize that it’s the people at the bottom of the totem pole that make your life possible” (Blair, 2013)

- *The orientation toward the customers.* The costumers are considered as an exploiting opportunity through which managers will perform their goals. With the help of the all mix-marketing tools as: product, price, distribution/placement and promotion, is trying to get benefits from the customer. In other words, the goal is to manipulate the customers, so the management and the organization can benefit.
- *The orientation toward the community*. The community is fully exploited. The environment is polluted extremely, while the community is fully under the organizations’ control. They use the community resources, without giving any benefit to it in return.

10.4.2 Amoral Entrepreneurial Managers

Entrepreneurial managers of this type are neither moral nor immoral. Amoral entrepreneurial managers lack the ethical conscience. There are two types of amoral entrepreneurial managers: intentionally amoral managers and non-intentionally amoral managers. Non-intentionally amoral managers do not take into consideration the ethical issues in their decisions, actions, and their behavior. They make decisions and do actions without being worried if that decisions or actions are ethical or not. Simply said, they may not think about the implications that these decisions and actions may have in different groups, which directly or indirectly are affected by them. Intentionally amoral managers think that the ethical issues, principles, and standards are needed in the private life and not in the business. They think that the business is done out of the area where is needed to be applied the ethical decisions and actions. However, the major number of the amoral managers belong to the non-intentionally amoral managers. As examples of an amoral management, can be detached those related with the tobacco and alcoholic drinks producers. They do not consider that their products might cause alcoholism, death because of drunkenness, lung cancer, low health quality etc. The managers of McDonald’s can be treated as an example of amoral managers, when they decide to use polystyrene containers for food packaging. They did not adequately take into consideration the adverse environmental impact that this decision will cause. Due to complaints by environmentalism associations, McDonald’s changed the decision and replaced the polystyrene packaging with paper products (Jamnik, 2011).

The orientation of this type of entrepreneurial managers toward different stakeholders is as follows:

- *The orientation toward the shareholders*. Under this type of management, there is not given any special attention to shareholders. They are considered as a part of the organization and it is enough to ensure minimal benefits. More precisely, there is not given attention to any group of people affected by their decisions, which means that is not given attention to the shareholders as well. The communication with shareholders is limited and is not expanded beyond what is predicted by law.

- *The orientation toward the employees*. Employees are considered as something that is demanded by the law. The concentration of these managers is to increase the employees' productivity and not the work satisfaction. Employees are still counted as productivity factor that brings profit. There is showed a minimal respect for the employees. The organizational structures, payments, incentives, and rewards are only fitted to increase the short-term and the long-term productivity
- *The orientation toward the customers*. The management is not focused on what is right from the customers' perspective. The focus is on managers' rights. There is not paid attention to the implications that may arise from the relations with the customers.
- *The orientation toward the community*. The community and its resources are not taken into consideration during the decision-making process. The community is irrelevant for the business. There are taken into consideration only the legal requirements, but nothing beyond that. They communication with the community is very low.

10.4.3 Moral Entrepreneurial Managers

Entrepreneurial moral managers are led by ethical standards and principles during their actions, decisions and behavior. Entrepreneurial moral managers want to realize profits from their activities, but only within the existing laws of a country, and within the ethical norms, principles, and standards. They would never admit to gain profit by violating the laws and the ethical standards. They are led by the justice, fairness and balanced principle. They are led by the 'golden rule', which says 'don't do unto others what you don't want others to do unto you'. As an example of an entrepreneurial moral management can be mentioned the compilation of "Four privacy principles" by IBM for protecting employees' intimacy and privacy. Also as entrepreneurial moral management can be considered the withdrawal of the company McCullough Corporation from the Chain Saw Manufacturers Association, because the association was not accepting the products' security standards. McCullough Corporation knew that in some of their products were present harmful substances for people, and was required from the Association to not use them anymore. The Association did not accept this request, by saying that it is not required by the law, which led the McCullough Corporation to withdraw from this Association (Carroll & Buchholtz, 2015).

The orientation of this type of entrepreneurial managers toward different stakeholders is as follows:

- *The orientation toward the shareholders*. The short-term and long-term of shareholders is in the spotlight. The best way to be ethical with the shareholders is to treat them perfectly. In order to protect the shareholders, this type of managers create an ethical committee within the organization. The organization has compiled code of ethics, which protects the interests of the shareholders and others stakeholders.
- *The orientation toward the employees*. Employees are an important resource and must be treated with dignity and respect. The goal is to be used a consultative/participative leadership style, which will result in mutual trust. The employees' rights, as privacy, free expression and security are highly respected during the decision making process. The management require a sincere cooperation with the employees. Nevzat Aydin, the owner and manager of 'Yemeksepeti', a website for selling food products, has decided that a part, respectively $27 million, from the money he got by selling his business, to allocate to his 114 employees. The German company 'Delivery Hero' bought 'Yemeksepeti' for $59 million. Nevzat Aydin had considered that employees are those who contributed for a successful business and deserve to be rewarded. Employees will get money, depending on how long have been working for the company; no one will get less than $215,000. He emphasized that 'the success did not happen overnight, but with work and devotion. . . I have led the business, but without the employees, I would be a zero'! (Kottasova, 2015).
- *The orientation toward the customers*. The customers are considered as equal partners. The needs and the expectations of the customers are treated fairly. The focus of the managers is to ensure a real value for the customers, sufficient information, security and satisfaction from the use of organization's products and services. The rights of the customers are always taken into consideration.
- *The orientation toward the community*. Managers offer help to institutions and the community when they need it. They help schools, sports' organizations, cultural activities and other philanthropic activities. Entrepreneurial managers of this type consider that the goals of the community and those of the company should be interdependent. Xhemail Dauti, the owner of Dauti-Komerc (dauti.com.mk), the company analyzed in Chap. 4, established a foundation (Dauti Foundation) and every year gives around 200 scholarships to students and pupils. Another entrepreneur from Skopje, Muharem Murtezani, the owner of Alma-M (www.alma-m.mk), the general distributor of the Nestle and Wrigley products in Macedonia and Kosovo, invested more than 150,000 Euros to modernize four schools in his community.

The ethical and legal behavior of the managers is of very immense importance. The managers as an individual, as leader of an organization should be a model for the others. Figure 10.4 once more shows that the manager's behavior is crucial in creating an ethical climate within the organization, where the manager is the main pillar of an ethical organization. The other pillars are the ethical leadership and the organizational structure and system.

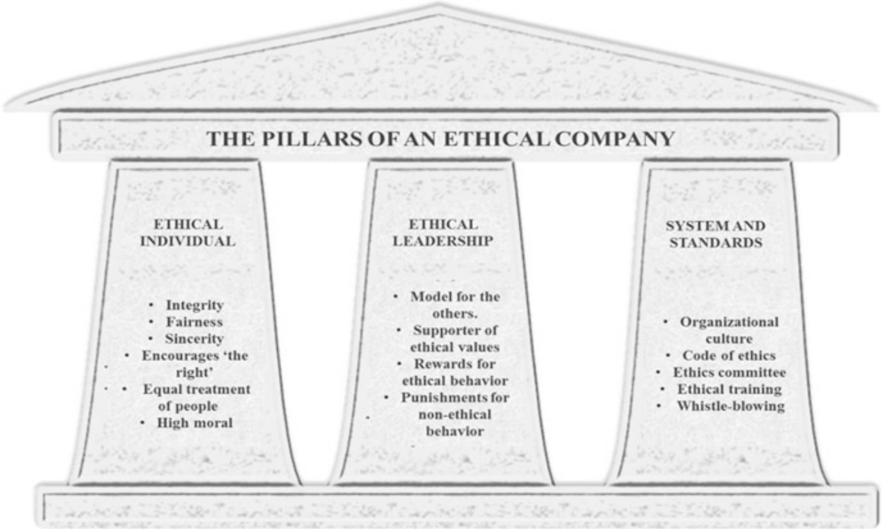

Fig. 10.4 Pillars of an ethical company. **Source**: Drawn by authors based on Trevino, Hartman, and Brown (2000, p. 131)

Ethical Individuals (Entrepreneurial Managers) Ethical entrepreneurial managers, as was mentioned above, represent the first pillar of an ethical organization. They are individuals with integrity and with great moral. They are led by the standards for fair relations and fair treatment of employees and other stakeholders, with whom have mutual relations. Besides being ethical, they also create conditions and climate that encourages ethical behavior of others.

Ethical Leadership The leadership has an important role in creating the climate for ethical behavior in organization. Leaders who are committed to ethical values create effective organizational culture. Leaders to encourage ethical behavior, commonly appoint various rewards for all employees that behave ethically. Despite creating ethical climate for the employees who perform in accordance with the ethical principles and standards to be rewarded, leaders must introduce also penalties for those who do not behave ethically. Consistent rewards and penalties represent very relevant components for creating an ethical leadership.

Organizational Structure and Systems The third pillar of an ethical organization is consisted of the organizational structures and systems, respectively the techniques used by the managers to promote ethical behavior. Here are included codes of ethics, ethical training and whistle-blowing. *Codes of ethics* represents a formal document that contain rules and standards, which describe the ways of acceptable behavior of employees. Codes of ethics represents a guideline for employees' ethical behavior. *Ethical training* represents a way for increasing the quality of the ethical behavior and enforces the application of ethical rules and standards, and at the same time decreases the undesirable employees' behavior within the organization. *Whistle-blowing* represents a revealing technique of non-ethical and illegal actions by the employees or managers. This technique is based on employees, who are willing to denounce the situations where can be detected non-ethical and illegal behaviors of any employee or manager. In order to, this technique be efficient, the organization must protect the employees who denounce any non-ethical and illegal activity, otherwise if these workers are identified may suffer any damage. Harry Barko, Jr., a former contract administrator for KBR in Iraq, who was stationed at Camp Al Asad, exposed that Halliburton/KBR by using a subcontract procedure overstated the costs of construction services on military bases in Iraq. Harry Barko brought an action claiming National Defense Fraud—violations of the False Claims Act by Halliburton/KBR. Halliburton/KBR asked the court to dismiss the action against them, but the U.S. District Court District of Columbia, on July 8, 2013, denied their request declaring that Harry Barko have provided a very detailed description of this falsehoods (http://www.whistleblowers.org/). Joe Speaker, a CFO at Rite Aid Corp. discovered in 1999 that inventories at Rite Aid had been overvalued and expenses had not been reported properly. Further digging revealed that $541 million in earnings over the previous two years were really $1.6 billion in losses. Based on the Speaker's whistle blowing, the former Chairman and CEO of Rite Aid Corp., Martin L. Grass went on trial (Pride, Hughes, & Kapoor, 2010).

10.5 Nature of Social Responsibility

In the last decades, despite the need to generate profit, companies are also faced with a new challenge—the social responsibility. They are no longer aimed only to generate profit and to satisfy the need and ambitions of their owners, but the spectrum of their goals is expanded with those that deal with the issues that concern the entire society.

In order to see how companies are involved in social responsibility's activities, during the period of January–April 2010 we conducted a survey with 119 small businesses that operate in Macedonia. The results from the survey, regarding to in which fields and in what forms these businesses express their social responsibility, are presented in Table 10.2. From there can be seen that companies operating in Macedonia, show their social responsibility by paying their employees regularly and fairly (85 answers), paying taxes regularly (83 answers), offering quality product to their customers (79 answers). Then follow: offering products with competitive prices, donating in cultural-artistic events or sports activities, offering help in building educational, sporting and religious facilities, contributing in ecological issues, offering training for knowledge and skills development, and hiring people with disabilities.

But, what actually means for a company to be socially responsible? Many academicians and researchers have made effort to give a definition for this concept

Table 10.2 Social responsibility's issues and activities

Issues	Number of answers	Percentage (%)
You offer quality products	79	18.85
You offer products with competitive prices	55	13.13
You pay the employees regularly and fairly	85	20.29
You offer your employees paid training and specializations	15	3.58
You pay taxes regularly	83	19.81
You donate in cultural-artistic events and sports activity	33	7.88
You help any non-government organization	12	2.86
You help building the educational, sports, and religious facilities	26	6.21
You contribute in ecological issues	16	3.82
You hire people with disabilities	9	2.15
Other	6	1.43
Total	419	100.00

Source: Authors' research

that would be widely accepted. The literature in this field gives us signals that they had not managed to overlook this issue. Based on this, in the literature we may read different definitions with respect to social responsibility. Some authors say that social responsibility includes the company's actions, which despite making profit, lead also to the fulfillment of the society's interests (Robins & DeCenzo, 2001), or social responsibility is a managerial obligation to make decisions and undertake actions that lead to the improvement of wellbeing of society and company (Daft, 2010). Social responsibility means also making profit for the shareholders (owners), fulfilling the obligations towards the society in accordance with respective laws and norms (Kreitner, Reece, & O'Grady, 1990). In addition, social responsibility represents the auspices of the company toward the society's problems, operationalized through decisions made by the company's management.

From the above mentioned definitions it can be concluded that during the definition of the social responsibility are taken several elements as a base, including: making profit for the owners, problems of a society and respective norms and laws within a country/society, in which the company realize its business operations.

10.6 Pyramid of Social Responsibility

According to the one of the most renowned scholar in the field of business ethics and social responsibility, Professor Archie Carroll, the social responsibility is made up of four components: economic responsibility, legal responsibility, ethical responsibility, and philanthropic responsibility (Fig. 10.5 and Table 10.3).

Fig. 10.5 The pyramid of social responsibility. **Source**: Based on Carroll (1991)

Economic Responsibility The elementary responsibility of every company is the economic responsibility. Historically, companies have ben founded as economic entities to produce goods and services to fulfill their own needs and the needs of the society. Therefore, every company is founded and operates to produce goods and services for which the society shows needs and interest, and to offer them into the market to make profit. Profit, respectively its maximization, is the main goal of any company. Only companies that make profit are able to fulfill the needs of their owners, customers, and other stakeholders. Without profit, there cannot any other goal be accomplished. Therefore, the main company's social responsibility is the achievement of a positive economic result.

Legal Responsibility The legal responsibility is on the second level of the social responsibility pyramid. If profit is the main goal of every economic entity, it necessarily has to be realized within the respective legal framework. Under the so-called 'social contract', the legal responsibility means doing business according to norm and laws of a particular country, which are often viewed as 'codified ethics'. If a company intentionally produces products with defects or offers products with expired date of usage, then it is performing its activity illegally. Therefore, the companies that do not respect the legal norms and rules do not fulfill their social responsibility.

Ethical Responsibility The ethical responsibility is on the third level of the social responsibility pyramid. It includes norms, standards and beliefs that express a concern about the employees, customers, shareholders, and the society

Table 10.3 Components of the economic, legal, ethical and philanthropic responsibility

Economic components	Legal components
It is important to perform in a manner consistent with maximizing earning per share	It is important to perform in a manners consistent with expectations of government and law
It is important to be committed to being as profitable as possible	It is important to comply with various federal, state, and local regulations.
It is important to maintain a strong competitive position	It is important to be a law-abiding corporate or citizen.
It is important to maintain a high level of efficiency	It is important that a successful firm be defined as one that fulfills its legal obligations
It is important that a successful firm be defined as one that is consistently profitable	It is important to provide goods and services that at least meet minimal legal requirements
Ethical components	Philanthropic components
It is important to perform in a manner consistent with expectations of societal mores and ethical norms	It is important to perform in a manner consistent with the philanthropic and charitable expectations of society
It is important recognize and respect new or evolving ethical/moral norms adopted by society	It is important to assist the fine and performing arts
It is important to prevent ethical norms from being compromised in order to achieve corporate goals	It is important that managers and employees participate in voluntary and charitable activities within their local communities
It is important that good corporate citizenship be defined as doing what is expected morally and ethically	It is important to provide assistance to public and private educational institutions
It is important to recognize that corporate integrity and ethical behavior go beyond mere compliance with laws and regulations	It is important to assist voluntarily those projects that enhance the community's 'quality of life'

Source: Based on Carroll (1991, pp. 40–41)

(community), and in most cases are more "rigorous" than laws. Different ethical movements, like environmentalism, consumerism or civic rights movements, during the last decades brought some ethical norms and standards to be converted into legal components of social responsibility. Ethical responsibility, by nature, is difficult to be defined, and as result, it is difficult to be applied in practice.

Philanthropic Responsibility The philanthropic responsibility is on the fourth level of the social responsibility pyramids, and is focused in company's voluntary activities in improving the welfare of the individuals and society. Philanthropy includes donations of money, equipment and time in humanitarian programs. However, if a company does not do this, it does not mean that this company is non-ethical and socially irresponsible. This responsibility is voluntary and the company's decisions are based on the good will to contribute in resolving society's issues. The philanthropic responsibility is the highest level of social responsibility, which is above the expectations of society and contribute enormously in improving the society's wellbeing.

10.7 Benefits from Social Responsibility

Social responsibility and queries related to it often can be very controversial. Some parties think that social responsibility should be incorporated within the activities of the company, while some others are against this. The reasons are numerous, for all parties. Yeldar (2004) provided some reasons why companies should be involved in social responsibility, as follow:

1. *Higher profitability*. Many researches have proved that there is a direct connection between the company's social responsibility practices and the profit. For example, a study by DePaul University, says that companies which are socially responsible have better financial results (based on annual sales) then other companies; or according to an 11-year study of Harvard, the stakeholder-balanced companies have shown four time higher development and eight time more employment then companies focused only at their shareholders.
2. *Lower operating costs*. There is a perception that the improvement of the systems for a better management with the environmental issues would cause higher costs, but in fact happens the opposite. Over the time, companies improve operational efficiency by decreasing waste production and water usage, by increasing the energy efficiency and in some cases by selling different material for recycling.
3. *Better image and reputation in society*. The business world practices have proved that reputation and positive image are very hard to be built. While the same can be destroyed in less than a day. The reputation of a company is as result of the trust established by the stakeholders towards the company. A clearly determined devotion toward the social responsibility can build this trust, which leads toward the further growth of the company.
4. *Increased sales and customer loyalty*. Numerous researches have shown that customers not only want safe and good products, but also want to know if the product they buy is produced in a socially responsible way. A study conducted in Europe in 2000 showed that 70% of the European customers say that social responsibility is important factor when they decide to buy goods and 1 of 5 of interviewed customers says that would pay more for products or services that come from companies that are socially and environmentally responsible. On the other hand, 1 of 6 customers will boycott products of socially irresponsible companies. The company's social responsibility can lead to new markets and new products' lines.
5. *Increased productivity and quality*. The continually efforts to improve the working conditions, to decrease the negative impacts on the environment, to increase the participation of employees in decision making, often lead to increased productivity and decreased rate of mistakes.
6. *Increased ability to attract and retain qualified employees*. The company's devotion to social responsibility can help to attract and retain qualified employees. People want to work for a company that is respecting their values and beliefs. They are no longer concerned only for their salaries and promotions.

According to a study, 78% of the employees would work for a company devoted in solving society issues, then receiving a higher salary.

7. *Potential reduced supervision by governmental authorities*. The more a company shows that is committed in social responsibility and working within the respective legislation, the softer will be the state regulators and government with the company. They can receive preferential treatment, when applying for particular permissions or other documents, and if a problem occurs they will be treated better if had been transparent and socially responsible during the time when the problem appeared.

10.8 Summary

Recently, business ethics and social responsibility raised a great attention among scholars, practitioners and policy-makers. Stakeholders, such as employees, customers, shareholders, government and community are increasingly requiring from the companies to be more ethical and be more responsible about social issues and problems. Media, also continuously is keeping in the spotlight the companies' abuses and misusing. Even the companies are assessing that being ethical and social responsible, or at least looking alike, can bring additional benefits for the business. An ethical or non-ethical behavior is a complex combination of several factors, such as the features of the individual, culture, organization and community. Being ethical and social responsible means that the company should operate within the accepted norms, standards and laws of the respective country/community. The benefits from the ethical behavior and the social responsibility could be summarized as follow: Higher profitability; lower operative expenses; enhanced image and reputation in society; increased sales and customer loyalty; increased productivity and quality; increased ability to attract and retain qualified employees and reduced supervision by governmental authorities.

Case Study: Rita and Her Ethical Dilemma

Rita owns and manages a consulting business. About a month ago, she decided that she needs to hire an assistant. After interviewing several candidates, she decided to hire the best candidate of the group, and she was Sara. She called Sara to tell her that she had been chosen. They both agreed that Sara would start working on next Monday, and in the same day will fill the all required employment documents.

On Tuesday, during the same week, Rron a friend of Rita, called her, and said that he had found the right person for her needs. She explained him that she had already hired Sara, but her friend was insistent by saying: "Just meet Miranda. Who knows, maybe you can hire her in the future!". Rita reluctantly

(continued)

agreed: “OK, if she can come tomorrow, I can meet her, but that’s all I can do”. Her friend replied: “OK. I know you will like her!”.

Rita met Miranda on Wednesday in the morning, and did like her very much. She was the real person that Rita was looking for. Regarding experience, she surpassed the all candidates that Rita interviewed earlier, including Sara. In addition, she was ready to bring her customers, and this was more than favorable for the business. But, what to do with Sara? Rita had already assured Sara that she could start working on Monday. At the moment, Rita can employ only one person. It’s clear that the best business decision was to hire Miranda, but what about the ethical decision? If her business will have poor performance, or Sara cannot offer sufficient support, the business can even bankrupt. Because of this, her family would suffer, but also she knows that Sara also was having a family depending on her, and also had been too enthusiastic about starting to work. A great ethical dilemma, isn’t it?

Questions

- How do you judge the Rita’s decision to hire Miranda and not Sara?
- Was ethical Rita’s decision? Provide strong arguments for your answer!
- What would you do in this situation, and why?

Source: This case is written and adapted from the authors based on information in Business Ethics, Available at: www.smallbusinessnotes.com/operating/leadership/ethics.html (Accessed: July 11, 2015)

Questions for Discussion

- What do you understand by business ethics?
- Which are the factors that influence the human ethical or non-ethical behavior?
- Count and explain the ethical standards!
- Explain the main ethical approaches!
- How are managers divided regarding their approach toward ethics?
- Explain the levels of the ethical behavior development!
- What do you understand by social responsibility?
- Explain the social responsibility pyramid!
- Which are the benefits from social responsibility?

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- http://lass.calumet.purdue.edu/cca/jgcg/downloads/BusinessEthics.pdf
- http://dspace.iimk.ac.in/bitstream/2259/392/1/17-27.pdf&embedded=true
- http://www.icsb.org/documents/Ethics_WashingtonDC_Paper_05.16.05.pdf
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Entrepreneurial Family Businesses and Succession Management

11

Learning Objectives
***After reading this chapter, you should be able to*:**

- define family business
- understand the life-cycle of the family business
- to explain the three-dimensional model
- to understand the types of conflicts in family business
- to identify the elements of the institutional clash
- identify stages of succession in family business
- know the factors that act against the succession planning
- know the basic characteristics of the family business

Profile: Byung-Chull Lee—Samsung
Byung-Chull Lee (1910–1987) is the founder of Samsung Group. He was the son of a wealthy landowning family, a branch of the Gyeongju Lee clan, in the Uiryeong County. On March 1, 1938, Byung-Chull Lee started a business in Taegu, Korea, with 30,000 won and 40 employees located in Su-Dong (now Ingyo-Dong). He named his business as Samsung Sanghoe Daegu. In Korean, Samsung means 'three stars'. His business was focused primarily on trade export, selling dried Korean fish, vegetables, and fruit to Manchuria and Beijing. In a decade, his business prospered very well and in 1947 he moved the company's head office in Seoul.

The Korean War forced him to leave Seoul and look for any other business opportunity. He founded Cheil Jedang, a sugar refinery in Busan and later, in 1954 Lee founded the largest woollen mill ever in the country. In 1961, beside many charges for illegal profiteery and family scandals of smuggling,

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Lee grew his business by diversifying into paper products, department stores and publishing. In 1969 he establishes Samsung Electronics, which was focused on producing of inexpensive TVs (Black-and-white TV model: P-3202), microwave ovens and other consumer products for Sears and General Electric. In 1970, Lee and Samsung expanded the business in ship building, petrochemicals and aircraft engines. In 1988, Samsung Electronics was merged with Samsung Semiconductors and Telecommunications, and its focus was in home appliances, telecommunications and semiconductors.

In 1987 Byung-Chull passed away. His son, Kun-Hee Lee, succeeded him as the new Chairman. Samsung group was separated in to four business groups leaving the Samsung Group with electronics, engineering, construction, and most high-tech products. Retail, food, chemicals, logistics, entertainment, paper, and telecom were spun out among the Shinsegae Group, CJ Group, and Hansol Group. Kun-Hee Lee challenged himself to restructure old businesses and enter new ones with the aim of becoming one of the world's top five electronics companies. Kun-Hee Lee, in 1996 was involved in a corruption scandal and got a suspended sentence for bribery. In 2008, he was involved again in corruption and bribery scandal with influential prosecutors, judges, and political figures in South Korea. Initially he denied the allegations against him, but later he pleaded guilty and said, "I am responsible for everything. I will assume full moral and legal responsibility." Seoul Central District Court had found Lee guilty on charges of financial wrongdoing and tax evasion. Prosecutors requested Lee be sentenced to 7 years in prison and fined 350 billion won ($312 million), but the court fined him just 110 billion won ($98 million) and sentenced him to 3 years in prison. Kun-Hee Lee has not responded to the verdict and some months later, the president of South Korea, Lee Myung-Bak, pardoned him.

During the late 80s and early 90s of the last century, Samsung Electronics made significant invesments in research and development in order to drive the company to the forefront in the global electronics industry. Here are some of the main investments that Samsung made during this period: In 1982, Samsung built a television assembly plant in Portugal; in 1984 and 1985, Samsung built a factory in New York and Tokyo; in 1987, built facilities in the UK and in 1996 built facilities in Austin. The investments of $5.6 billion in Austin was considered as the largest foreign investment in Texas and one of the largest single foreign investment in the US. The 1990s are considered as years, when Samsung started to rise as an international company. The construction branch of Samsung was contracted to build one of the two Petronas Towers in Malaysia, Taipei 101 in Taiwan and the Burj Khalifa in Dubai. In addition, Samsung manufactures a variety of aircraft of the 1980s–1990s. However, Samsung Motor sold 80.1% of its stakes to Renault due to significant losses. Samsung, in comparison to many Korean companies,

(continued)

survived the well-known Asian financial crisis in 1997 and had only minor effects in its business operations.

Later, the main concentration of Samsung was in electronics, where in 2005, Samsung became the world's largest manufacturer of LCD panels. In 2006, Sony partnered with Samsung in 2006 to develop a stable supply of LCD panels for both companies. Although, it was a 50:50 partnership, Samsung owned one share more than Sony, in order to have control over the manufacturing. In 2011, Samsung bought Sony's stake in the partnership and took full control. In 2012, Samsung became the largest manufacturer of mobile phones. In order to remain this position, Samsung has earmarked \$3–\$ 4 billion to upgrade their Austin Texas semiconductor manufacturing facility. On September 3, 2014, Samsung announced the virtual reality device, Gear VR, which was developed in collaboration with Oculus VR for the Galaxy Note 4. In October 2014, Samsung announced a \$14.7 billion investment to build a chip plant in South Korea. In October 2014, Samsung announced a \$560 million investment in the construction of a new 700,000 m^2 production complex in Vietnam.

Samsung applies an excellent method of quality control, called "Stop Line" system, which inform the employees that the product is found to be substandard and they should stop the production process. This system made the company to be successful in providing only the best products to the whole world. It applies a

The main subsidiaries and affiliates are: *Samsung SDS* (provides IT systems: ERP, IT Infrastructure, IT Consulting, IT Outsourcing, Data Center); *Samsung Electronics* (produces air conditioners, computers, digital televisions, liquid crystal displays, active-matrix organic light-emitting diodes, mobile phones, monitors, printers, refrigerators, semiconductors and telecommunications networking equipment); *Samsung Engineering* (construction of oil refining plants; upstream oil and gas facilities; petrochemical plants and gas plants; steel making plants; power plants; water treatment facilities; and other infrastructure); *Samsung Everland* (Environment & Asset, Food Culture and Resort), *Samsung Life Insurance* (a multinational life insurance company), etc.

Samsung is the largest South Korean business group, accounted for around 15% of the country's GDP in 2012. In 2014, the Samsung's revenues were \$305 billion; net income was \$22.1 billion; total assets were \$529.5 billion, total equity was \$231.2 billion and the number of employees was 489,000.

Today, Samsung continues to be the best technology provider in the world. Samsung is characterized by highly qualified employees, who are very determined in offering excellence in their respective fields and with the constant improvement of its management structure and the application of its philosophies: "We will devote our human resources and technology to

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create superior products and services, thereby contributing to a better global society."

Sources: This profile is written from the authors based on information in: http://www.samsung.com/us/aboutsamsung/corporateprofile/history06.html; http://www.mercurynews.com/ci_22979868/samsung-short-history; http://components.about.com/od/Companies/p/The-History-Of-Samsung.htm; http://www.reuters.com/finance/stocks/companyProfile?symbol=028050.KS http://successstory.com/companies/samsung-group

11.1 Introduction

Family businesses represent the majority of companies and are an important source for the generation of jobs in most countries (Hacker & Dowling, 2012; Hoy & Sharma, 2010; Ramadani, Bexheti, Rexhepi, Ratten, & Ibraimi, 2017). Multiple research studies have recorded the predominance of family firms in countries throughout the world. The prevalence of family businesses also documents both the economic and social impact they have (Brigham, 2013). It should be emphasized that not all family businesses are small. In 2006, *Bloomberg Business week* reported that 35% of companies listed in the Fortune 500 could be classified as family businesses (Perman, 2006). Some relevant data regarding the significance of family firms are shown in Table 11.1.

Longevity is very important for the family businesses and for economies as a whole. Succession is one of the most difficult decisions for the family business, and one of the most important (Molly, Laveren, & Deloof, 2010; Sardeshmukh & Corbett, 2011). When business leadership transitions are not well structured they may cause expensive legal issues leading to the sale or eventual loss of the business (Lipman, 2010; Morris, Williams, Allen, & Avila, 1997).

This chapter presents a review of some important issues related to family businesses, such are family business categories, members of family businesses, succession process, family business cultures, conflicts in family businesses, etc.

11.2 Defining Family Businesses

Family firms constitute the dominant and oldest form of business organizations. Understanding family firms ranges from small enterprises serving a neighborhood, to large conglomerates that operate in multiple industries and countries (IFC, 2008). Therefore, the definition of a family business is a complex issue. The key component represents the interaction of the family system and business (Chua, Chrisman, & Sharma, 1999). The founding editors of *Family Business Review* asked, "What is family business? People seem to understand what is meant by the term *family*

Table 11.1 Family business: numbers and facts

Family business constitute	80–98%	Of the business in the worldwide free economy
Family business produces	49%	Of the gross domestic product (GDP) in the United States of America
Family business produces more than	75%	Of the gross domestic product in the most countries worldwide
Family business employs	80%	Workforce in the US
Family business employs more than	75%	Of the workforce worldwide
Family business creates	86%	Of new jobs in the US
A total of	37%	Of Fortune 500 companies are family businesses
A total of	60%	Of all public companies in the US are under the control of family businesses
The number of family-owned businesses in the United States is	17 million	
The number of family-owned businesses in the US with revenues greater than 25 million is	35,000	
Performance of family businesses from non-family businesses in the US	6.65% a year in returns on assets (ROA)	10% in market value
Performance of family businesses from non-family businesses in Europe	8–16% per year in Return on equity (ROE)	

Source: Based on Poza (2010) and Poza and Daugherty (2013)

business, yet when they try to articulate a precise definition they quickly discover that it is a very complicated phenomenon" (Lansberg, Perrow, & Rogolsky, 1988, p. 1). Hoy and Verser (1994) noted that the editors chose not to define the term family business, instead deciding that the dialogue engendered by *Family Business Review* might help determine the boundaries of the field. The editors expected manuscript submitters to specify what definition they were using so that readers would know how to compare studies. Some of criteria that are often used to define family businesses are presented in Table 11.2.

The general concept of the family business includes any business in which the bulk of the ownership or control lies in a family, and in which two or more family members are involved directly (Brockhaus, 2004). Family business is a double complex system, comprising business and family. These systems overlap and are both dynamic organisms that develop and change and are both unique with their particular history, challenges, strengths, weaknesses, opportunities and threats that are exposed. Family members who are involved in the business are part of a system of tasks of business and part of the family system. For this reason, conflicts may occur because each system has its own rules, roles and requirements. Families can have their own style of communication and conflict resolution which can be good

Table 11.2 Criteria used to define family businesses

Definitional criterion	No. of occurrences	Frequency (%)
Ownership	98	79
Management	66	53
Directorship	35	28
Self-identification	19	15
Multiple generations	11	9
Intra-family succession intention	9	7
Total	238	100

Note: Percentages add to more than 100% because studies typically use multiple criteria
Source: Based on De Massis, Sharma, Chua, Chrisman, and Kotlar (2012, p. 13)

for the family but it does not mean that this will be good for resolving business disputes. Entry to the family system is from birth, adoption and marriage, with membership assumed to be permanent; whereas entry into the business system is based on experience and opportunities. Conflicts may arise when the problems from one system are transferred to the other system (Bowman-Upton, 2009; Gashi & Ramadani, 2013).

A definition of family business should determine why it is unique, and this raises the question of "what is unique?" This has nothing to do with the fact that family members own or manage a business. What makes a family business unique is that the model of ownership, governance, and succession management materially affects the objectives, strategies, structure, and the way in which it is formulated, designed and implemented as business activity (Chua et al., 1999; Mandl, 2008).

According to Poza and Daugherty (2013) if a business is to be considered a family business it must meet the following characteristics: (a) ownership control (15% or higher) by two or more members of the family; (b) strategic influence by family members on the management of the firm, either by being active in management, continuing to create culture, serving as an advisor or board member, or by being an active shareholder; and (c) concern for family relationships; the dream or possibility of continuity across generations. Further to this list of features, Poza and Daugherty add several features: (a) the presence of the family; (b) the overlap of family, management, and ownership, with its zero-sum (win–lose) propensities, which in the absence of growth of the firm, render family business particularly vulnerable during succession; (c) the unique sources of competitive advantage (e.g., a long term investment horizon), derived from the interaction of family, management, and ownership, especially when family unity is high; and (d) the owner's dream of keeping the business in the family (the objective being business continuity from generation to generation). Alderson (2011, p. 6) defines a family business as a "business governed and/or managed in order to form and follow the vision of the business held by a dominant coalition controlled by members of the same family or a small number of families that is potentially sustainable in all generations of the family or families."

Table 11.3 Main differences between the family and non-family business

	Family business	Non-family business
Centre of the firm	Family (formally or informally/directly or indirectly influencing the firm)	Owner(s)/managers
Necessary governance	Company and family sphere	Company sphere
Main objective	Economic and non-economic (sustainability/long-term family income (stability) as well as family satisfaction)	Economic (quick profits/growth)
Mindset orientation	Transfer among generations, sustainability over the life time of the enterprise	Sale of the business, sustainability over the professional life time of the entrepreneur
Competitive strategy	Quality, reputation, long-term relationships	Price
Assets	Financial, social, cultural	Financial
Company climate	Familiness, trust, cohesion, involvement, commitment, engagement, enthusiasm, informality	Business goal orientation, formality, contractual agreements, distance
Business orientation	Satisfaction of internal and external stakeholders (mainly family, clients, employees, local community)	Satisfaction of owners/shareholders
Management style	Value-driven, emotional, goal alignment	Facts-and-Figures-driven, rational, agency control mechanisms
Allocation of profits	Reinvestment into the company	Distribution among owners/shareholders

Source: Based on Mandl (2008, p. 70)

Family businesses differ from non-family ones in many ways. Differences between them, based on a review of different studies, are summarized in Table 11.3. There can be seen that in the centre of the firm in family businesses is family, which formally or informally, directly or indirectly influence the firm; their main objectives are both economic and non-economic, respectively sustainability/long-term family income (stability) as well as family satisfaction; their business orientation is satisfaction of internal and external stakeholders (mainly family, clients, employees, local community); the style of management is value-driven, emotional and goal alignment, they compete on quality, reputation, long-term relationships etc. Alternatively, in the centre of non-family businesses are owner(s) or managers; their main objectives are only economic (quick profits/growth); their business orientation is satisfaction of owners/shareholders; the style of management is facts-and-figures-driven, rational and use agency control mechanisms, etc.

A very important issue raised recently is whether the family business should be "family business" during the whole its life-cycle or not. Mandl (2008) noted that the status of being a family business must not be considered "fixed" (Fig. 11.1). According to her, there are several businesses that are family businesses over their whole life cycle (Fig. 11.1a). On the other hand, there are businesses which could be 'transferred' over their life cycle from family business to non-family business and vice-versa. For instance, a business may start as a family business, which is owned and managed by family members, but over the time, property and management due to various reasons may be distributed or transferred to persons outside the family and in the maturity phase, the business will lose the status of being a family business (Fig. 11.1b). Some businesses could reach the status of being a family business again in their declining phase, if non-family members (owners or managers) withdraw from the business and hence, the family power ceases (Fig.11.1c). Also, often it could happen that a business is established as a non-family business consisted of the entrepreneur and few non-family members only. Later, when the entrepreneur and his/her children grow, the issue of transfer of business and interest of the second generation to take over the business may occur, which intensifies the role and involvement of the family in the business. After the completion of the transfer phase, two situations can happen: the entrepreneur and his/her family are still involved in the business (Fig. 11.1e) or they could withdraw from the business and shifting the status of the business from "family" to "non-family" (Fig. 11.1d).

Based on the variety of definitions introduced in this section, it can be concluded that even today there is not a generally accepted definition for family business (Chua et al., 1999). Commonly, ***family business*** could be defined as a business that is owned and governed by the family, in which are employed some of its members and is based on the assumption that the younger members of the family will set control over the business, following the elder ones.

11.3 Participants in the Family Business

In general, participants in a family business can be divided into two groups: family members and non-family members. These groups are shown in Fig. 11.2. Sharma (2004) divides them into internal and external family business members. Internal members are those who are involved with the business, such as employees, owners and/or family members. External members are those who are not linked to the family business, whether through employment, ownership or family membership. Venter, van der Merwe, and Farrington (2012) categorize participants in family business into four groups: *non-family members* (includes non-family employees, outside professionals, experts, consultants, advisors, who offer expertise and skills, are part of the management team and assist in strategic business decisions), *inactive family members* (includes those members who are not being involved in the family business in terms of interfering in the business decision-making or disagreements), *the senior generation* (includes parents and their willingness to delegate authority, share important information related to the business and resign control, as well as ensuring their financial protection after retirement) and *the incumbent generation* (includes children as active family members being able to realise their personal ambitions and satisfy their career needs in the context of the family business). Each participant has personal approaches and ways of thinking and abilities to put pressure on business and family (Bowman-Upton, 2009; Sharma, 2004).

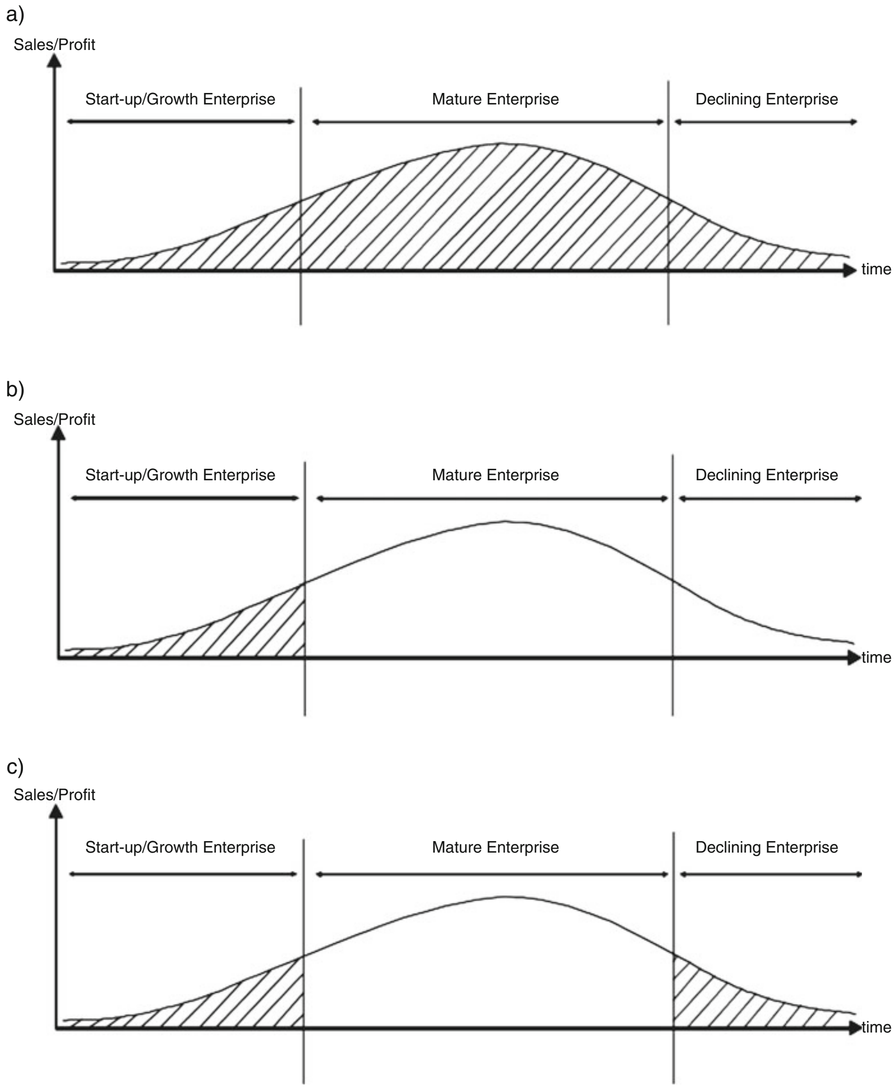

Fig. 11.1 Potential family businesses status over the company life-cycle. (**a**) Family business status during the whole life cycle. (**b**) Family business status during the start-up/growth phase only. (**c**) Family business status during the start-up/growth and declining phase. (**d**) Family business status in mature phase only. (**e**) Family business status from mature phase onwards. **Source**: Based on Mandl (2008, pp. 14–15)

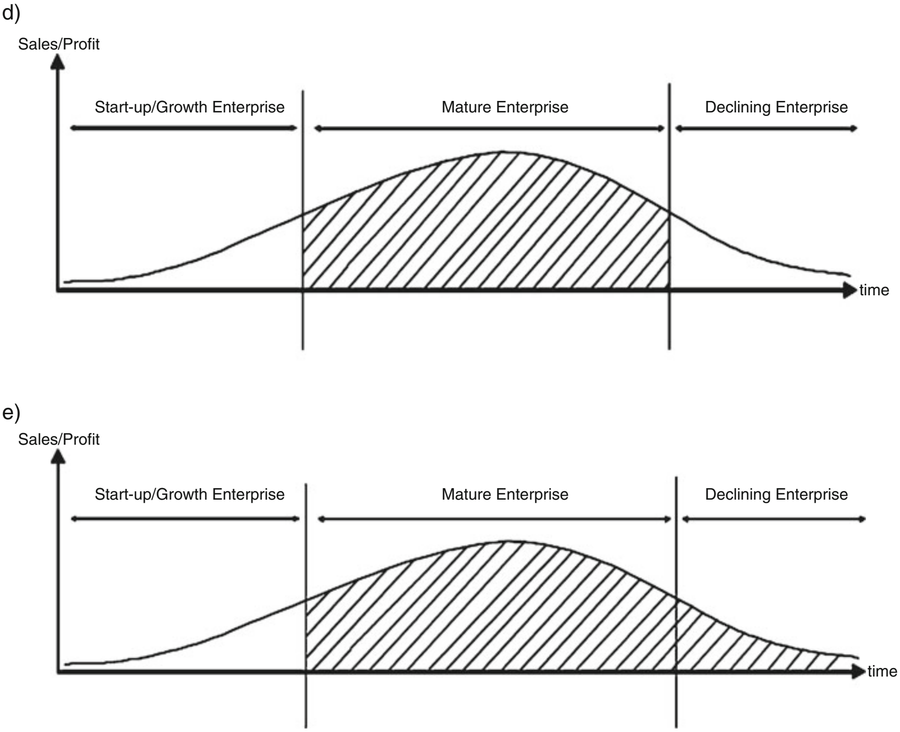

Fig. 11.1 (continued)

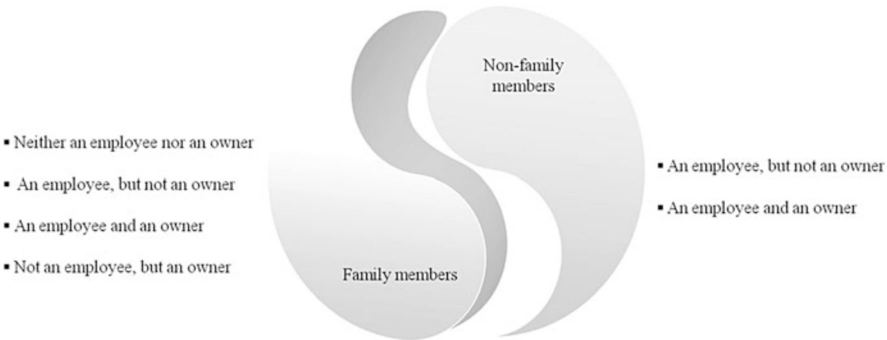

Fig. 11.2 Participants in the family business. **Source**: Based on Bowman-Upton (2009)

1. Family members
   (a) *Neither an employee*, *nor an owner*. In this group usually belong children and in-laws. Even though they may not be part of the business, however, have the opportunity to influence and exert pressure on the family that runs the business. For example, children can criticize their parents for spending too much time on business and very little devotion to them. This presents a

problem because raises feelings of guilt to parents for not finding time for their children and this can affect business decision making. In-laws may be counted as outsiders, intruders or allies and are usually neglected, ignored and misunderstood. For example, from daughter-in-law is required to support and understand her husband in business activities without a clear understanding of family or business dynamics. It can lead to problems in family or putting her between family confrontations. Sons-in-law are in the same situation or difficulties. They can be counted as competitors from the wives' brothers. Sons in-law, although may not be involved in business, they can exert pressure on families and businesses through their wives.

(b) *An employee*, *but not an owner*. These members are active in the business, but do not have an ownership position. For this group, there may raise problems of different nature. For example, when compared with those family members who are not employees, but are business owners, raise the feeling of inequity. This situation is often manifested with the words: "while I do all the work, others just stick and reap profits." Or the problem may occur when owners bring decisions without consultation with employees, family members who are not owners. This is manifested by the words: "I deal with daily affairs of the company, knowing how decisions will affect the company's work, while they do not ask me about it at all." Employees, family members generally expect to be treated differently from employees who are not part of the family.

(c) *An employee and an owner*. The members of this group may have the most difficult position in the enterprise. They must manage effectively with all members involved in both of systems, family and business. As owners, they are responsible for the welfare and business continuity, as well as for daily business activities. They must deal with the concerns of employees that are family members and for those who are not. In this group fall founders, as owners and executive directors.

(d) *Not an employee*, *but an owner*. This group consists of brothers/sisters and retired relatives. Their main interest is the income/profit provided by the business and everything that might jeopardize this, can be a problem for them. For example, while managers/owners wish to implement development strategies that can spend the wealth and put it in danger, it may encounter resistance from retired relatives who are concerned primarily about dividend or profit from business.

2. Non-family members

(a) *An employee*, *but not an owner*. This group of employees often faces with the issues of nepotism and coalition building as a result of family conflicts caused by daily business activities. Family business owners to employees who are not family members and who have little or no option at all for promotion (advancement) should try to uphold their motivation by implementing appropriate policies of recruitment, accepting children of nonfamily employees into the business and minimizing policies that favor family employees over nonfamily employees.

(b) *An employee and an owner*. With the introduction of plans and opportunities for corporate enterprise transformation, this group becomes very important. Employees may become owners during the succession process. In businesses where a successor is selected, partial ownership of the business by its employees can accelerate the cooperation with the new management, because employees will be more interested about the benefits and responsibilities of the business. In situations where the successor is not selected, a part of the business is likely to be sold to employees who are not part of the family, but who have actively participated in its development. The employees in this case will require to be treated as owners, which can be difficult to detect and accept by family members.

11.4 Family and Business Overlapping

Carlock and Ward (2001) described a family business as a scale which should be balanced between the requirements and business opportunities and the needs and desires of the family. The balance between these two 'forces'—business and family—can be achieved based on five variables: (a) *control*: setting in a fair way who will participate or make the decisions; (b) *career*: need to make it possible for family members to be rewarded and promoted based on their performance; (c) *capital*: family members can reinvest without damaging the interests of other family members; (d) *conflict*: conflict must be addressed due to the proximity between business and family; and (e) *culture*: family values have to be used in the development of plans and actions.

The essential problem in the functioning of family enterprises is the institutional overlap of norms in which families and businesses rely. Institutional overlap is shown in Fig. 11.3. The primary role of the family is to maintain social relations among its members, while the economic function of the company is to produce and provide products and services, the sale of which will generate satisfactory profit. One way to overcome this institutional collision is to acknowledge the decisions, arising as a result of a compromise between contradictory family and business principles. This way of decision-making, however, often results in suboptimal decisions, regarded from management aspects. Family members that work in the family business and fail to align personal goals with those of the business should question their position or status in the business. Also, in family businesses the career path and the training of the family members should be planned (Lansberg, 1983).

A two-dimensional model of two interrelated systems, the family and the business, has driven many research studies. Tagiuri and Davis (1996) introduced the three-circle model, where the dimension of ownership was added. Figure 11.4 presents the *Three-Circle model of family business*, which shows how individuals can be included in a family business: as family members, as owners and as workers/managers (see also Sharma & Hoy, 2013).

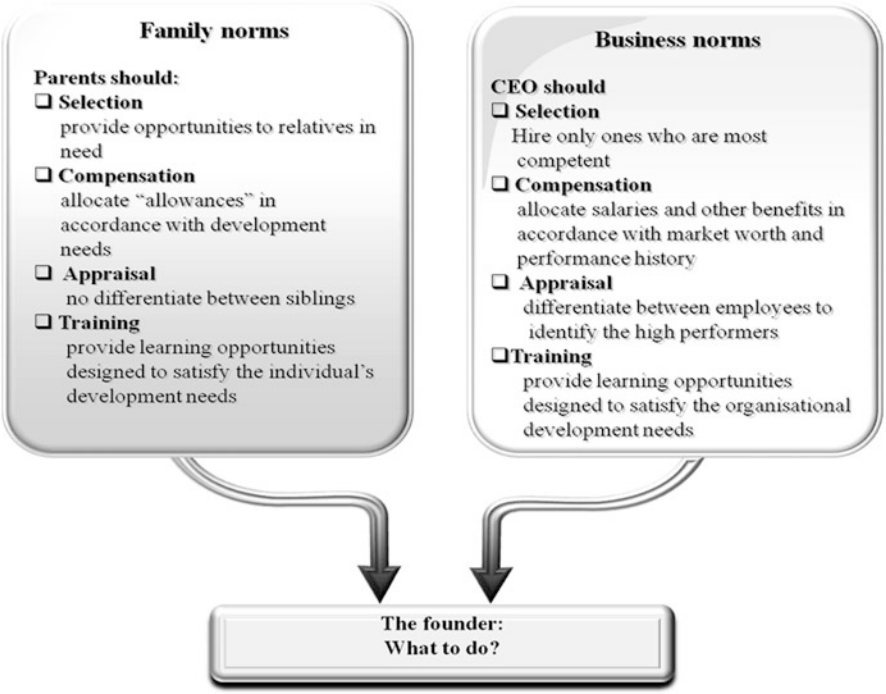

Fig. 11.3 Institutional overlapping in family businesses. **Source**: Based on Lansberg (1983)

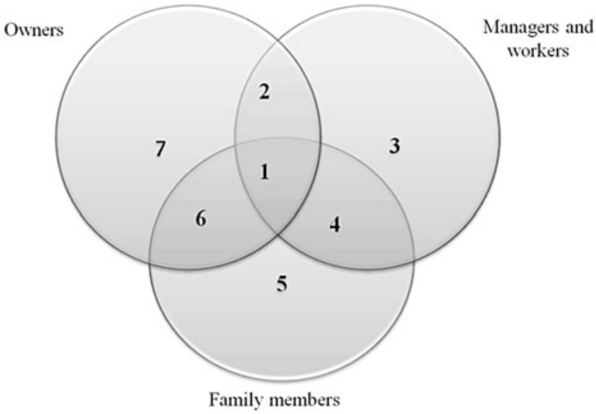

Fig. 11.4 Three-circle model of family businesses. **Source**: Based on Tagiuri and Davis (1996) and Hoy and Sharma (2010)

This model represents: family members who are employed and are owners (1); family members who are employed, but are not owners (4); employed in the family business which are not family members (2); employed in a family business who are not family members and are not owners (3); non-family owners (7); family

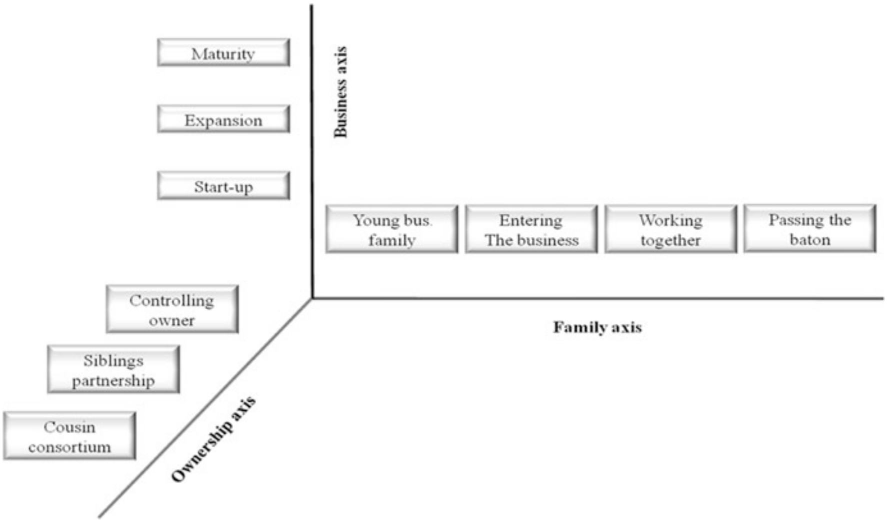

Fig. 11.5 Three-dimensional development model. **Source**: Based on Gersick et al. (1997, p. 17)

members who are not employed in the family business, but are owners (6), and family members that are not involved in the business (5).

Gersick, Davis, McCollum Hampton, and Lansberg (1997) elaborated on the Three-dimensional model by building a *Three-Dimensional Developmental Model*, which consists of ownership, family and business axes. The ownership axis includes four stages: controlling owner, sibling partnership and consortium of cousins. The family axis includes four stages: young business family, entering the business, working together and passing the baton. And, the business axis goes through the four stages of start-up, growth/formalization and maturity. This model is presented in Fig. 11.5. Hoy (2012), in his review of Gersick et al. (1997) *Generation to Generation*, noted that, the Tagiuri and Davis *Three-Circle Model* remains dominant in education and consulting practice, even though in a Google Scholar search, there can be found over twice as many citations for Gersick et al. (1997) as for Tagiuri and Davis (1996).

11.5 Conflicts in the Family Business

Jehn and Mannix (2001) define conflicts as "awareness on the part of the parties involved of discrepancies, incompatible wishes, or irreconcilable desires" (p. 238). Sorenson (1999) notes that conflict represents one of the defining characteristics of a family business and this status may have come from highly exposed family disputes in which volatile conflicts destroyed families and businesses. Conflict's sources are different. Major sources of conflicts in family businesses are presented in Table 11.4.

Table 11.4 Major sources of conflicts

			2013 breakdown by firm size			2013 breakdown by generation	
Major sources of conflicts (in order of most common)	2013 all firms rank	2011 survey rank	Small rank	Medium rank	Large rank	First generation rank	Second generation rank
Future visions, goals and strategy	1	1 1		2	4	2	1
How decision are made	2	n/a	3	4	1	3	2
Managing growth	3	n/a	6	1	3	5	3
Competence of family in the business	4	2	5	3	5	4	5
Financial stress	5	n/a	2	6	7	1	7
Lack of family communication	6	4	4	5	2	6	4
Remuneration	7	6	7	7	10	10	6
Succession-related issues	8	3	10	9	6	7	11
Lack of family/non-family communication	9	5	8	10	8	8	9
Sibling rivalry	10	7	9	8	16	11	8

Source: Based on KPMG (2013, p. 17)

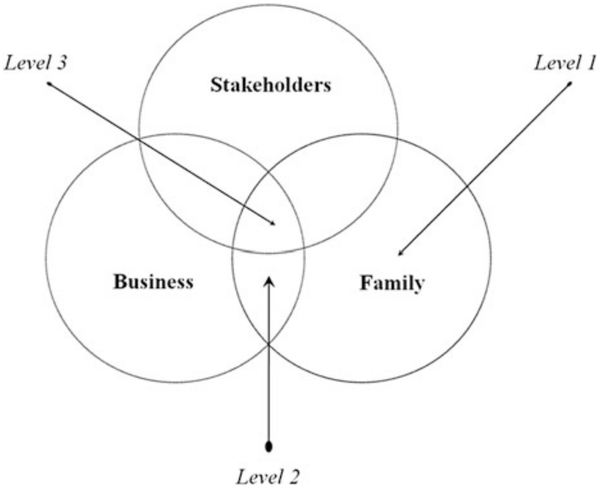

Fig. 11.6 Conflict levels in family businesses. **Source**: Drawn by authors based on Harvey and Evans (1994, p. 343)

Clashes between business and family norms cause various types of conflicts. Based on Harvey and Evans (1994), interaction between business, family and external stakeholders creates three levels of conflicts that occur in the family business, presented in Fig. 11.6. In the first level, there are conflicts that do not occur as a result of interaction between three entities (business, family and external stakeholders) and have no effect on other entities. So, they occur within an entity, for example within the family. In the second level, conflicts arise between two entities collide among themselves. These conflicts are complex. Their sources may be different and when you combine sources among themselves, they become more complex and very difficult to be solved. In the third level, conflicts that occur include all three entities involved in the family business and are among the most complex and difficult to solve.

Harvey and Evans (1994) noted that conflict resolution in the family business depends on the level of conflict, namely by how entities are involved in the respective conflict. The mechanism of first level conflict resolution, when occurring within the family circle, is the ability of the family member. The character of changes is not too significant. The motive for the resolution of conflict comes from inside and the entrepreneur/owner is directly involved in its solution. For this reason it is not necessary supervision during the implementation of the resolution. Conflict resolution is heavier and more complex in the second level, due to the involvement of two entities. The character of changes is transactional. For this, conflict resolution should be undertaken by a group of individuals. It is necessary to supervise the changes that lead to conflict resolution to ensure that they really are resolved. The most complex level of conflict, the third level, involves three entities, business, family and stakeholders. Due to the complexity of these conflicts, it is necessary to engage external consultants to solve them. Entrepreneur/owner will be part of the team along with consultants to resolve conflicts. Due to the involvement of more subjects, supervision is essential and comprehensive.

Regarding conflict resolving issues, Dean (1992) surveyed 234 African American family-owned businesses in Los Angeles and verified that 53% of them use owner authority to resolve conflicts, 31% use compromise, 23% use consensus, and 2% use mediators.

11.6 Family Business Culture

Culture represents a way of thinking and understanding during a process of judgment, evaluation and obedience. It is a way of dealing with others. Culture refers to the set of values that are shared by people in a group and have a tendency to continue over time even when group membership changes (Kotter & Heskitt, 1992). Family culture can be described as a way family members resolve conflicts and differences, express emotions, and understand reality, separation and loss (Kepner, 2004). Family culture is comprised of four layers: artifacts, values, perspectives, and assumptions (Dyer, 1986; Schein, 1985; Sharpe, 2014). Artifacts are the surface-level aspects of culture, which can be categorized as (Dyer, 1988): physical (type of dresses, cars, company logo, and other emblems used by families); verbal (language, jargon, stories, etc.); and behavioral (ceremonies, rituals and other behavioral patterns). Values are broad tendencies, principles, standards and norms that determine what an individual considers to be good or bad (Hoy & Sharma, 2010); they represent those 'forces' what drive behaviour and what lead to confident artifacts within a family's culture (Koiranen, 2002; Sharpe, 2014). Dumas and Blodgett (1999) analysed fifty family business mission statements and identified these values: quality, commitment, trust, social responsibility, honesty, fairness, respect and integrity. A perspective could be defined as a synchronized set of ideas and actions used by family in dealing with different problematic situation (Becker, Geer, Hughes, & Strauss, 1961). Assumptions are the premises on which a family bases its global views and on which the artifacts, values and perspectives are based (Dyer, 1988).

Family business culture plays an essential role in determining the continuity of success after the first generation. As Dyer (1988) noted "family business cultures can either contribute to success or be a major stumbling block. To understand and manage the opportunities inherent in family business cultures is not easy, and it is not often done in family firms, but it is essential for leaders who wish to ensure the continuity of their businesses and the well-being of their families" (p. 50). These insights come from the research of more than 40 family businesses.

Family business cultures are categorized differently from different authors. For example, Kets De Vries (as cited in Duh & Belak, 2009) identifies these types of family business cultures: an avoidance culture (an insidious sense of ineffectiveness), charismatic culture (everything depends and goes around the leader), paranoid culture (a persecutory subject matter), bureaucratic culture (very rigid and depersonalized), politicized culture (leadership responsibility is relinquished). Hofstede (1998) classified family business cultures by comparing the degree of individualism versus collectivism, the tendency towards uncertainty avoidance, the bias between masculinity and femininity and the apparent power-distance metric.

11.7 Succession Management Issues

The succession process in family business represents a very complex and important issue. Alan Crosbie (2000) draws a fine analogy between running a family business and flying a plane, where he says: "There is not much danger to anybody when the plane is in the third hour of a transatlantic journey, but at take-off and landing the craft is much more vulnerable to an accident. The point of succession is very much like landing and taking off again. It presents a radically greater threat of danger, than is posed by any of the other periods in the history of the company" (p. 105).

Cadieux and Lorrain (2002) noted what primarily differentiates a family business from a non-family business is the succession process, including capital and management know-how. The succession process represents also a difficult issue in terms of the time needed to prepare the management succession. Poutziouris (2001) noted that "about 30% of all European enterprises now face business transfer. Moreover, estimates suggest that 30% of such business transfers will not materialize because failure to plan can be tantamount to planning to fail" (p. 278).

The transfer of the position of the leader does not automatically mean stabilization of the power of the successor. The preparation of the successor for leadership is a process of socialization or development aspect of the succession. The time during socialization should help the successor perform the duty of the leader in a successful manner. The time for learning is also included in this part (Boyatzis & Soler, 2012). The succession is a function of these independent variables: property, management, successors, leadership, age of the business, complexity of the business, financial performance and proximity of succession. The essence of succession is measured by ranking of the importance of these issues: keeping property in family, keeping control in family, election of successor, conflict resolution between family members, rewarding of family members and finding positions for incompetent family members (Chua et al., 1999). Succession plays a key role in the influence on the desired future of the family business (Kamei & Dana, 2012; Shi & Dana, 2013).

Indicators of independent variables for measuring of the importance of keeping the property in family, keeping the control in family, election of successor, conflict resolution between family members, rewarding of family members and finding positions for incompetent members of the family are given in the Table 11.5.

Longenecker, Moore, and Petty (2000) offered a model of succession that consists of three levels and seven stages. In this model the first level includes introductory activities, which must be performed before the successor enters the business. This includes the following phases: pre-business phase, introductory phase and introductory functional. The second level includes activities dealing with the successor's entry in the enterprise as an employee in a regular relationship. Activities relating to the transfer of business leadership to successor constitute the

Table 11.5 Independent variables and indicators

Independent variable	Indicator type	Indicator
Property	Formative	Percentage of property by family
Management	Reflective	Number of family members involved in bussines and relations between non-family managers towards family members
Successors	Reflective	Number of potential successors, male or female
Leadership	Formative	Percentage of outside members in the board of directors
Business age	Reflective	Age of business and leadership of business through generations
Business complexity	Reflective	Gross income, regional distribution of sales, number of commercial locations and number of full-time employees
Financial performance	Formative	Percentage of 'active' return?
Succession proximity	Formative	Whether the current CEO will retire in the next 10 years

Source: Based on Chua et al. (1999, p. 31)

third level. These include the early stages of succession and succession maturity. The stages of this model are treated below:

1. *Pre-business phase*. This is the stage where the potential successor is notified of the business. At this stage, a basis for succession is created that will happen in the coming years. Here, potential successors accompanied by a parent of the business visits the offices and warehouses of the company, and plays with equipment dealing with the business in order to become more familiar with business.
2. *Introductory phase*. This phase includes those experiences that relate to the period before a successor will be of legal age and is willing to join the business part-time. This is the stage where the child is notified with people and other aspects that are directly or indirectly related to the business, such as the introduction of the child to any collaborator or banker.
3. *Introductory functional phase*. This is the stage where the potential successor is employed in the business part-time and during breaks, or after school hours. At this stage the successor is involved in formal education and working in other enterprises. Also at this stage, the successor develops special relationship with the people in the enterprise.
4. *Functional phase*. This is the stage where the successor has completed formal education and is employed full time and indefinitely in the company. Before he/she advances to managerial positions he/she may engage in different jobs within the company as in accountancy or sales, and be fitted with different experiences. This stage for the successor includes granting initial non-managerial tasks.
5. *Advanced functional phase*. At this stage the successor takes on a managerial position that has to do with the management of the workers but not the entire

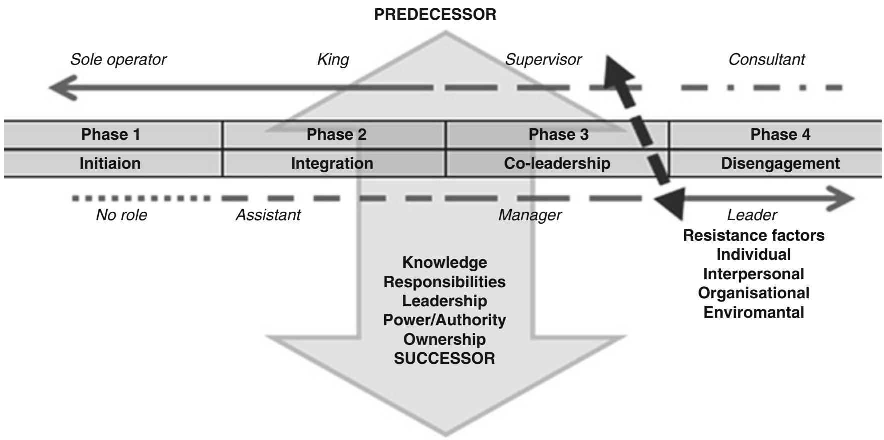

Fig. 11.7 The process of succession. **Source**: Based on Cadieux and Lorrain (2002, p. 6)

company. He/she may engage in various managerial positions before becoming the general leader of the company.

6. *Early succession phase*. This is the stage when the successor has been named president and general manager of the company. At this stage successor is de jure leader of the enterprise because he/she performs this function with the help of parents.
7. *Mature succession phase*. This phase usually begins 2 to 3 years after the successor was appointed chairman or general manager of the enterprise. Now, the successor is the de facto leader. But in some cases this does not happen until a parent dies, because for some leaders it can be difficult to leave the business and to give up the management of the enterprise. This is the stage which completes succession.

As it was noted by Dakoumi Hamrouni and Mnasser (2013) and Cadieux and Lorrain (2002) completed a synthesis of different academic studies on the process of succession andsummarised four phases, as follows (Fig. 11.7):

1. *Initiation phase*. In this phase, the owner of the family business, respectively the predecessor is master and commander, where he is primarily occupied with the current and total management of the business. In the initial phase the predecessor has the intention of one day ceding the business to his or her successor(s), and in this phase there are few chances for the successor(s) to be involved in the business.
2. *Integration phase*. In the second phase the successor will be integrated in the business. During this phase, the successor undergoes an apprenticeship period, where he will have the chance to gain the needed technical knowledge and managerial skills to ensure the continuity and development of the family business.

3. *Joint-management phase*. Here, the successor officially assume his or her title in the business, which means progressive transfer of responsibilities, know-how and authority on the part of the predecessor. In these phase could be created certain tensions between the predecessor and the successor, which are followed by consequences on the activities of the business. To avoid these tensions and conflicts it is necessary to share tasks, duties and competences between the predecessor and the successor.
4. *Disengagement phase*. This is the last phase of the succession process. It is only completed if the predecessor has effectively retired and transfered responsibilities, leadership, authority and ownership to the successor.

In family businesses, continuity transition imposes a wide variety of important changes. Family relationships must be rebuilt, traditional patterns of impact redistributed, and management and ownership structures that have been around for a long time, should open the way for new structures. Among the factors affecting the succession planning process are (Lansberg, 1988; Leach, 2011):

(a) *Founder*—although the founders are often aware of the benefits that come from succession planning, they also face psychological obstacles to manage their exit from the business. A difficult obstacle to continuity planning is the founder's reluctance to cope with his/her death, as to begin continuity planning means that he or she is approaching death. The founders also resist continuity planning because it includes giving up directing the daily business operations. Also, they may resist planning because of the fear that retirement means that they may lose the position and respect in the family, and could lose a significant part of their identity. Or, simply, they think that the successors are not ready yet for this. Ingvar Kamprad, the founder of IKEA (the Swedish enterprise for furniture with cheap prices for the middle-class families, whose wealth is assessed to be $52.5 billion in 2004, being greater than the one of Bill Gates with $46.2 billion) has three sons from the second marriage, Peter being 46, Jonas 43 and Matthias 41 years old. They all work at IKEA. In regards to family business succession, Ingvar Kamprad has once said: "I am proud of my three sons. They are very smart. However, I don't think that anyone of them is ready to lead the company, at least for now" (Shuklev & Ramadani, 2012).

(b) *Family*—in order to understand the reactions of family succession planning, and the reasons why family members may be against planning, it is important to consider the stage of the life cycle in which succession will occur in the family business. Another reason is that the retirement and change of status that comes with it can worsen things. There can be a lack of desire for open discussion about the succession. The younger generation sometimes avoids succession planning because it brings about fear of parental death, separation or abandonment. But, if there is no decision regarding this issue, a lot of problems could appear in the future, as Shi and Dana (2013) noted in their research in Japan, where Yu says: "Succession process planning? Of course it would be useful. It would be better to do it. My father and me, we didn't have such a thing. We could have done better, if we had had someone, consultant or specialist to whom my father and I, we could give our confidence. For us the succession process did not work as we hoped. My grandfather died. And after that, my uncle, Tadashi arranged the things in the family. Just at the moment when we really needed him, he died too. And after that the conflict continued and then my father died. Then, the incidents happened again and again. This was a painful test for me. But I have the impression that it is this kind of test that trains me" (p. 69).

(c) *Managers*—difficulties related to succession planning are not only experienced by the founder and family. Many senior managers are willing to change their relationship from the personal relationship they have with the founders in formal relations with the followers. Managers do not want to limit their autonomy and their impact on the budget, information management systems and personnel.

(d) *Owners* affect succession planning, as the founder provides shares for the purpose of their motivation to be involved in the family business, and these owners do not want to open the issue of succession because they fear they will betray the founder. Fear that the successor would not be the best person to take over the business, is another reason business owners refuse to plan the succession.

(e) *Environment* affects succession planning. These forces consist of suppliers of clients who have grown dependent on the founder as their main contact in the business, and these people know that the founder is the one with whom to talk. They may fear that the successor can terminate those relationships created by the founder.

11.8 Advantages and Disadvantages of Family Business

According to what was mentioned up to this point, we can identify several advantages and disadvantages of the family business (Dana & Ramadani, 2015; Ramadani & Hoy, 2015). The advantages of the family business are:

1. Family members are owners and managers of the business, and ownership is potentially inherited in the future generations. Therefore, the majority of these businesses reinvest their profits in the business;
2. Employment of family members means employment of people who have multiple interests in the success of the business. If problems occur, most probably they will be more worried than an ordinary employee who is not a family member;
3. Family business represents a benefit not only for the family, but for the society as well. A family business, besides employment of family members, provides job opportunities also for other people who have values and capabilities to deal with business;

4. Another advantage can be improvement of relations with customers. It frequently happens that a family business has close familiar or friendly relations with many customers, which guarantees the long-term stability of the business. Customers perceive that the family name on the company is a symbol of trust, i.e., that the family will not want to jeopardize its reputation through poor, unethical or illegal practices.

As all businesses, however, the family business has its disadvantages. Some of them are mentioned below:

1. Family business can be the cause to many problems in family: gambling, anxiety, worries, drug and alcohol abuse, etc. It is in very rare cases that family emotions do not interfere with business practices at some point;
2. Family business managers find it hard not to employ their relatives, even when they do not possess the skills required in the business. Moreover, in many cases these family members have been found to misuse their positions in the business, just because they are part of the family.
3. Family members, more specifically parents who have spent many years at the top of the business cannot accept the fact that the time has come for them to be replaced by descendants or other family members who will manage the business better and bring something more innovative to the family business.

11.9 Summary

This chapter treated the family businesses and succession management. The complexity of family businesses arises as a result of the interconnectedness of two separate systems of family and business where each one has different needs and wants, with uncertain boundaries, different roles and different rules. Family businesses have to be able to show preparedness in terms of managing business and family overlapping, most importantly, trying to balance the requirements and business opportunities and the needs and desires of the family. Research suggests this can be achieved through the five variables of: control, career, capital conflict, culture. Succession involves the transfer of the assets, capital, contacts, power, skills, and authority from one generation to the next in a family business. Even though succession is a very important process for the continuity of the business, its success it can be problematic. Moreover, succession planning requires a harmonizing personal aspirations and family goals. Therefore, the generation in power must let go and the succeeding generation must desire to be involved in the business.

Case Study: Euro-Aktiva and the Succession Issues

Euro-Aktiva was established by Nuhi Aliu and operates in Macedonia and Kosovo as well. Euro-Aktiva has started its business in 1996 in Kosovo, being as an exclusive distributor of Sidenor which is a successful company based in Greece, which manufactures mainly steel but sells as well other building materials. Euro-Aktiva has started its roots 15 years ago, mainly selling building materials in Kosovo, then after 5 years the same business started operating in Skopje as well.

Indeed, Euro-Aktiva started expansion by becoming a distributor for many other companies which contributed in achieving of becoming a leader in the building business, by covering 70% of the Macedonian market and 80% of the Kosovo market. Since then it has continually expanded its market in many other branches such as opening a petrol station, restaurant, service for cars, it has its own security agency, construction and building and gathering scrap metal. Moreover, we believe that the founder who has also been the owner for 15 years has entrepreneurial soul who is always looking for new opportunities in the market that are more likely to add more value to the name Euro-Aktiva and make it even more stronger. If we present the business plan of Euro-Aktiva you are about to see how completed and related every branch and aspect of this business family is.

The owner together with his two brothers has stick together in the worst and best times of this company by putting the needs of the company first and then dividends were distributed after the storms would leave. This company still is led in a traditional way, there is no board in charge but the owner is willing to start changing the day to day operations. The founder is still the owner and the CEO where one of the brothers is the vice president and finance consulate and the other one is in charge of supplies. The three main and strongest positions are led by them since they still feel the need to be in charge of everything. The owner thinks that the best time to transfer the business management is between 55 and 60 where he himself is slowly approaching that age. Therefore, he believes that the next 5 years managing together with the offspring's will help the next leaders gain higher experience and he will be more positive that the family business will run more years to come successfully.

As we mentioned above, this is a family run business where the owner has always emphasized the long term continuity of this company mainly because most of the employees hired are family.

Around 50% of the employees are family members, starting from the lowest position to the highest. Nevertheless, communication and trust between family and business is high which has helped maintain control and effectiveness over the business for all these years.

(continued)

The founder and the brothers have prioritized and encouraged their children to study and get well educated by sending them outside the country for a better education. Moreover, the second generation has started working at a young age whether as a salesperson in one of the markets they have or working at one of their warehouses for building materials. Nevertheless, they have been part of the family business while they were in high schools which has appointed and prepared them from that age that one day they are going to have to be part of this business. Furthermore, there was no room for other "dreams" or whatsoever; the decision has already been made. In their defense, the next generation had everything they needed ready to show more success and grow even more.

Moving on, as the offspring grew, responsibilities grew for them. The daughter of the owner and the son of one of the brothers had finished their master studies, so now the company was starting to adapt to the family structure and have divisions accordingly to them so each of them can be included. The owner has always encouraged their heirs to be part of other projects as well occurring in this country whether in non-governmental or foreign organizations in order to gain more experience. He says "I need to have you fully prepared for our market, so people, companies will have to pay you for your opinion". Moreover, what his point has always been that no matter what happens in the future with this company you are still going to be able to survive by finding good jobs if you have the needed background. Nevertheless, the responsibilities did not finish here, the heirs had to enrich their social networks and grow each day more.

The founder continues to be the CEO till his retirement but he is looking into joining venture before he leaves. One of the businesses of Euro-Aktiva has already created partnership with a Turkish company but he is looking forward to have the entire company partnered with the same Turkish company in order to move the company into a higher and more perspective level.

Questions

1. What kind of problems can be appeared in the future in this family business? How should they be solved?
2. What will you recommend to Mr. Aliu regarding the succession issues?
3. What Mr. Aliu thinks when he says to his heirs: "I need to have you fully prepared for our market, so people, companies will have to pay you for your opinion"?

Source: This case is written from the authors based on interview with Nuhi Aliu on October 20, 2014

Questions for Discussion

- How do you define family business?
- Explain the three-dimensional model of the life cycle of the family business!
- What do you understand by institutional clash? Illustrate it with an example!
- Explain the three levels of conflicts in the family business! How can we solve them?
- What do you understand with the succession process? Explain the stages of this process!
- What factors act against the succession planning?
- What are the advantages and disadvantages of the family business?

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- http://www.familybusiness.unh.edu/usefulinfo/FamilyBusinessFacts.pdf
- http://www.smihq.org/public/publications/past_articles/Springs_Jan_06.pdf
- http://www.translationdirectory.com/pdf/pub_mp3.pdf
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