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Small Business, Entrepreneurship, and Franchising

Learning Objectives

After reading this chapter, you will be able to:

- LO 5-1 Define *entrepreneurship* and *small business*.
- LO 5-2 Investigate the importance of small business in the U.S. economy and why certain fields attract small business.
- LO 5-3 Specify the advantages of small-business ownership.
- LO 5-4 Summarize the disadvantages of small-business ownership, and analyze why many small businesses fail.
- LO 5-5 Describe how you go about starting a small business and what resources are needed.
- LO 5-6 Evaluate the demographic, technological, and economic trends that are affecting the future of small business.
- LO 5-7 Explain why many large businesses are trying to “think small.”
- LO 5-8 Assess two entrepreneurs’ plans for starting a small business.

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Enter the World of Business

Chobani Yogurt Fights for Dominance in the Yogurt Market

For the founder of Chobani Yogurt, it took more than a good idea to propel the company into what it is today. It was almost by chance that Hamdi Ulukaya made it into the billion-dollar venture it is now. At one time, Greek yogurt accounted for less than 1 percent of the yogurt market in the United States; it now makes up 50 percent. With the help of a Small Business Administration loan, Ulukaya purchased a small yogurt plant Kraft was selling. Ulukaya decided to sell Greek yogurt, a product he knew was popular in other parts of the world.

When Chobani yogurt hit shelves in 2007, the product was an immediate success. Unlike his contemporaries, Ulukaya does not outsource but maintains control of the entire manufacturing process. Under his leadership, the company has become a challenger to the top yogurt makers in the industry in only a matter of years. It is for this reason that Hamdi Ulukaya has been nicknamed the “Steve Jobs of yogurt.” Today, Chobani Yogurt is netting more than \$1 billion in sales and controls 17 percent of the yogurt market.

Chobani Yogurt has recently faced some challenges. For instance, in fall 2013 the company had to recall its yogurt after reports that mold growing in the yogurt made consumers sick. Later that year, Whole Foods decided to drop Chobani Yogurt from its shelves. Chobani is also facing increased competition from more established rivals such as Danone’s Oikos brand and Yoplait Greek.¹

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Introduction

Although many business students go to work for large corporations upon graduation, others may choose to start their own business or to find employment opportunities in small organizations with 500 or fewer employees. Small businesses employ about half of all private-sector employees.² Each small business represents the vision of its owners to succeed through providing new or better products. Small businesses are the heart of the U.S. economic and social system because they offer opportunities and demonstrate the freedom of people to make their own destinies. Today, the entrepreneurial spirit is growing around the world, from Russia and China to India, Germany, Brazil, and Mexico. For instance, within eastern Europe, approximately 24 percent of the population is engaged in entrepreneurial activities. Within the BRIC countries (Brazil, Russia, India, and China), the average is only slightly less at 21 percent.³

This chapter surveys the world of entrepreneurship and small business. First we define entrepreneurship and small business and examine the role of small business in the American economy. Then we explore the advantages and disadvantages of small-business ownership and analyze why small businesses succeed or fail. Next, we discuss how an entrepreneur goes about starting a business and the challenges facing small businesses today. Finally, we look at entrepreneurship in larger organizations.

LO 5-1

entrepreneurship
the process of creating
and managing a business
to achieve desired objectives

The Nature of Entrepreneurship and Small Business

In Chapter 1, we defined an entrepreneur as a person who risks his or her wealth, time, and effort to develop for profit an innovative product or way of doing something. **Entrepreneurship** is the process of creating and managing a business to achieve desired objectives. Many large businesses you may recognize (Levi Strauss and Co., Procter & Gamble, McDonald's, Dell Computers, Microsoft, and Google) all began as small businesses based on the visions of their founders. Some entrepreneurs who start small businesses have the ability to see emerging trends; in response, they create a company to provide a product that serves customer needs. For example, rather than inventing a major new technology, an innovative company may take advantage of technology to create new markets, such as Amazon.com. Or they may offer a familiar product that has been improved or placed in a unique retail environment, such as Starbucks and its coffee shops. A company may innovate by focusing on a particular market segment and delivering a combination of features that consumers in that segment could not find anywhere else. Tweezerman, which manufactures beauty tools, became successful after its founder, Dal LaMagna, developed diamond tweezers directed specifically for beauty salons. For many years, the company only sold tweezers but has since expanded to encompass a range of other beauty tools.⁴

Of course, smaller businesses do not have to evolve into such highly visible companies to be successful, but those entrepreneurial efforts that result in rapidly growing businesses gain visibility along with success. Entrepreneurs who have achieved success, like Michael Dell (Dell Computers), Bill Gates (Microsoft), Larry Page and Sergey Brin (Google), and the late Steve Jobs (Apple) are some of the most well known. Table 5.1 lists some of the greatest entrepreneurs of the past few decades.

The entrepreneurship movement is accelerating, and many new, smaller businesses are emerging. Technology once available only to the largest firms can now

| Company | Entrepreneur |
|-------------------------|-----------------------------|
| Hewlett-Packard | Bill Hewlett, David Packard |
| Walt Disney Productions | Walt Disney |
| Starbucks | Howard Schultz |
| Amazon.com | Jeff Bezos |
| Dell | Michael Dell |
| Microsoft | Bill Gates |
| Apple | Steve Jobs |
| Walmart | Sam Walton |
| Google | Larry Page, Sergey Brin |
| Ben & Jerry's | Ben Cohen, Jerry Greenfield |
| Ford | Henry Ford |
| General Electric | Thomas Edison |

TABLE 5.1
Great Entrepreneurs of
Innovative Companies

be obtained by a small business. Websites, podcasts, online videos, social media, cellular phones, and even expedited delivery services enable small businesses to be more competitive with today's giant corporations. Small businesses can also form alliances with other companies to produce and sell products in domestic and global markets.

Another growing trend among small businesses is social entrepreneurship. *Social entrepreneurs* are individuals who use entrepreneurship to address social problems. They operate by the same principles as other entrepreneurs but view their organizations as vehicles to create social change. Although these entrepreneurs often start their own nonprofit organizations, they can also operate for-profit organizations committed to solving social issues. CEO of TOMS Shoes Blake Mycoskie is an example of a social entrepreneur who founded the firm with the purpose of donating one pair of shoes to a child in need for every pair of shoes sold to consumers. Muhammad Yunus, founder of micro-lending organization Grameen Bank, is another example of a social entrepreneur. Yunus seeks to combat poverty by providing small loans to low-income individuals to start their own businesses.

What Is a Small Business?

This question is difficult to answer because smallness is relative. In this book, we will define a **small business** as any independently owned and operated business that is not dominant in its competitive area and does not employ more than 500 people. A local Mexican restaurant may be the most patronized Mexican restaurant in your community, but because it does not dominate the restaurant industry as a whole, the restaurant can be considered a small business. This definition is similar to the one used by the **Small Business Administration (SBA)**, an independent agency of the federal government that offers managerial and financial assistance to small businesses. On its website, the SBA outlines the first steps in starting a small business and offers a wealth of information to current and potential small-business owners.

small business

any independently owned and operated business that is not dominant in its competitive area and does not employ more than 500 people

Small Business Administration (SBA)

an independent agency of the federal government that offers managerial and financial assistance to small businesses

TABLE 5.2
Importance of Small
Businesses to Our
Economy

| |
|---|
| Small firms represent 99.7 percent of all employer firms. |
| Small firms have generated 63 percent of net new jobs. |
| Small firms hire approximately 37 percent of high-tech workers (such as scientists, engineers, computer programmers, and others). |
| Small firms produce 16 times more patents per employee than large patenting firms. |
| Small firms employ nearly half of all private-sector employees. |
| Small firms pay 42 percent of the total U.S. private payroll. |

Source: Small Business Administration Department of Advocacy, "Frequently Asked Questions," March 2014, www.sba.gov/sites/default/files/FAQ_March_2014_0.pdf (accessed April 10, 2014).

The Role of Small Business in the American Economy

No matter how you define a small business, one fact is clear: They are vital to the American economy. As you can see in Table 5.2, more than 99 percent of all U.S. firms are classified as small businesses, and they employ about half of private workers. Small firms are also important as exporters, representing 98 percent of U.S. exporters of goods and contributing 33 percent of the value of exported goods.⁵ In addition, small businesses are largely responsible for fueling job creation and innovation. Small businesses also provide opportunities for minorities and women to succeed in business. Women-owned businesses are responsible for employing 7.7 million workers and contribute \$1.3 trillion in sales. Women own more than 8 million businesses nationwide, with great success in the professional services, retail, communication, and administrative services areas.⁶ Minority-owned businesses have been growing faster than other classifiable firms as well, representing 21.3 percent of all small businesses.⁷ One successful business was started by a refugee from Belgrade, Serbia (formerly Yugoslavia). Although Marie Gray's early life was filled with hardship in WWII Yugoslavia, she immigrated to the United States and later used her passion for clothing to develop the women's dressmaker brand, St. John. Today, the company earns \$346 million in annual revenue.⁸

Job Creation. The energy, creativity, and innovative abilities of small-business owners have resulted in jobs for many people. About 63 percent of net new jobs annually were created by small businesses.⁹ Table 5.3 indicates that 99.7 percent of all businesses employ fewer than 500 people. Businesses employing 19 or fewer people account for 89.8 percent of all businesses.¹⁰

Many small businesses today are being started because of encouragement from larger ones. Many new jobs are also created by big-company/small-company alliances. Whether through formal joint ventures, supplier relationships, or product or marketing cooperative projects, the rewards of collaborative relationships are creating many jobs for small-business owners and their employees. In India, many small information technology (IT) firms provide IT services to global markets. Because of lower costs, international companies often can find Indian businesses to provide their information processing solutions.¹¹

Innovation. Perhaps one of the most significant strengths of small businesses is their ability to innovate and to bring significant benefits to customers. Small firms produce more than half of all innovations. Among the important 20th-century innovations

| Firm Size | Number of Firms | Percentage of All Firms |
|-------------------|-----------------|-------------------------|
| 0–19 employees | 5,104,014 | 89.8 |
| 20–99 employees | 481,496 | 8.5 |
| 100–499 employees | 81,243 | 1.4 |
| 500+ employees | 17,671 | 0.3 |

Source: "Statistics of U.S. Businesses (SUSB)," *Statistics of U.S. Businesses*, www.census.gov/econ/susb/index.html (accessed April 10, 2014).

TABLE 5.3
Number of Firms by
Employment Size

by U.S. small firms are the airplane, the audio tape recorder, fiber-optic examining equipment, the heart valve, the optical scanner, the pacemaker, the personal computer, soft contact lenses, the Internet, and the zipper. For instance, the founder and CEO of the small firm UniKey, Phil Dumas, invented a new way for consumers to keep their doors locked. Dumas invented Kevo, a motorized deadbolt lock that links to users' iPhones. With just the touch of a finger, consumers can lock and unlock their doors from remote locations. UniKey distributes products in major retailers such as Lowe's and Home Depot. This is just one example of a small company with the ability to innovate and contribute to the benefit of customers.¹²

The innovation of successful firms take many forms. For instance, small firms make up approximately 52 percent of home-based businesses and 2 percent of franchises. Many of today's largest businesses started off as small firms that used innovation to achieve success.¹³ Small businessman Ray Kroc found a new way to sell hamburgers and turned his ideas into one of the most successful fast-food franchises in the world—McDonald's. Small businesses have become an integral part of our lives. J. Darius Bikoff founded Glaceau in 1996 to market enhanced water drinks. He built his small



Jeffrey Lubell founded premium apparel company True Religion in 2002. It has gone on to be listed among *Forbes'* best publicly traded small companies in America.

business offering slightly flavored drinks in health food stores into a nationally recognized company that Coca-Cola acquired in 2006. Its brands—including VitaminWater and SmartWater—are still popular today.¹⁴ Travis Kalanick co-launched the successful company Uber, an app-based car service company rapidly growing in cities throughout the world. The Uber app allows consumers to rent a car or driver on demand. The cars arrive within a few minutes of the order. Much like Ray Kroc, Kalanick's innovative concept has the potential to change its industry—its low cost and convenience is making it a major player in the transportation rivaling traditional cab companies.¹⁵ Entrepreneurs provide fresh ideas and usually have greater flexibility to change than do large companies.

LO 5-2

Industries That Attract Small Business

Small businesses are found in nearly every industry, but retailing and wholesaling, services, manufacturing, and high technology are especially attractive to entrepreneurs. These fields are relatively easy to enter and require low initial financing. Small-business owners in these industries also find it easier to focus on specific groups of consumers; new firms in these industries initially suffer less from heavy competition than do established firms.

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Retailing and Wholesaling. Retailers acquire goods from producers or wholesalers and sell them to consumers. Main streets and shopping centers and malls are generally lined with independent music stores, sporting-goods stores, dry cleaners, boutiques, drugstores, restaurants, caterers, service stations, and hardware stores that sell directly to consumers. Retailing attracts entrepreneurs because gaining experience and exposure in retailing is relatively easy. Additionally, an entrepreneur opening a new retail store does not have to spend the large sums of money for the equipment and distribution systems that a manufacturing business requires. All that a new retailer needs is a lease on store space, merchandise, money to sustain the business, knowledge about prospective customers' needs and desires, and basic management and marketing skills. However, it is important for entrepreneurs to anticipate the costs of opening a retail or wholesale business beforehand. When Patrick Leon Esquerré decided to open up a French bakery, he invested \$100,000 into the bakery—all the money he had. He was able to raise more money from friends in France and Texas and opened up his first bakery, La Madeleine. After guests started asking for food, Esquerré used his mother's recipes to expand the menu. Eventually, the company began selling its products through stores such as Sam's Club. Esquerré's initial \$100,000 investment has led to 63 restaurant locations today.¹⁶



The retailing industry is particularly attractive to entrepreneurs. Pike's Perk Coffee & Tea House is a small locally owned coffee shop in Colorado Springs, Colorado.



From Farmer's Market to Franchiser: Auntie Anne's Soft Pretzels

Auntie Anne's Soft Pretzels

Founder: Anne Beiler

Founded: 1988, in Downingtown, Pennsylvania

Success: Auntie Anne's is the largest soft pretzel franchise in the world with sales of \$410 million.

Auntie Anne's Soft Pretzels began as a weekend operation at a farmer's market in Downingtown, Pennsylvania, in February 1988. Founder Anne Beiler received a \$6,000 loan from her husband's parents to buy a pretzel stand at the farmer's market. In the first weekend, the business earned close to \$1,000. Beiler experimented with the pretzel recipes, and the final product was twice as profitable as the

original. She bought more ovens, hired more employees, and was soon making \$2,000 each weekend. The company used sampling to market the product.

In July 1988, Beiler opened a store in Harrisburg, Pennsylvania, and by the end of the year made approximately \$100,000. Beiler received repeated requests from people wanting to sell her product, so she decided to allow friends and family to open 10 new stores under a licensing agreement. By 1990, there were 75 locations in several states. Now owned by Focus Brands, Auntie Anne's is the largest soft pretzel franchise in the world with 1,200 shops in 26 countries.¹⁷

Wholesalers supply products to industrial, retail, and institutional users for resale or for use in making other products. Wholesaling activities range from planning and negotiating for supplies, promoting, and distributing (warehousing and transporting) to providing management and merchandising assistance to clients. Wholesalers are extremely important for many products, especially consumer goods, because of the marketing activities they perform. Although it is true that wholesalers themselves can be eliminated, their functions must be passed on to some other organization such as the producer, or another intermediary, often a small business. Frequently, small businesses are closer to the final customers and know what it takes to keep them satisfied. Some smaller businesses start out manufacturing, but find their real niche as a supplier or distributor of larger firms' products.

Services. The service sector includes businesses that do not actually produce tangible goods. The service sector accounts for 80 percent of U.S. jobs, excluding farmworkers. Real-estate, insurance and personnel agencies, barbershops, banks, television and computer repair shops, copy centers, dry cleaners, and accounting firms are all service businesses. Services also attract individuals—such as beauticians, morticians, jewelers, doctors, and veterinarians—whose skills are not usually required by large firms. Many of these service providers are retailers who provide their services to ultimate consumers.

Manufacturing. Manufacturing goods can provide unique opportunities for small businesses. Consider Nashville-based specialty chocolate company Olive & Sinclair. Within four years of its founding, the company was selling chocolates in the United States, London, Singapore, and Japan. The manufacturing of the chocolate is distinctively “southern” in nature. Its varieties include two ingredients—buttermilk and brown sugar—commonly associated with the South and a grinding process used to make Southern-style grits. This association appeals to global consumers. Today, Olive & Sinclair manufactures 1,500 chocolate bars each day.¹⁸ Small businesses sometimes have an advantage over large firms because they can customize products to meet specific customer needs and wants. Such products include custom artwork, jewelry, clothing, and furniture.

DID YOU KNOW? Small businesses hire 37 percent of high-tech workers in the United States?¹⁹

High Technology. *High technology* is a broad term used to describe businesses that depend heavily on advanced scientific and engineering knowledge. People who were able to innovate or identify new markets in the

fields of computers, biotechnology, genetic engineering, robotics, and other markets have become today's high-tech giants. One innovative technology was developed by a teenager interested in virtual reality. Only a few years ago, virtual reality was considered a dead technology past its prime. However, when 19-year-old Palmer Luckey developed a virtual gaming headset, it caught the attention of programmer John Carmack. Together, they brought virtual reality to a new level for gamers. The company, Oculus Rift, was sold to Facebook for \$2 billion.²⁰ In general, high-technology businesses require greater capital and have higher initial startup costs than do other small businesses. Many of the biggest, nonetheless, started out in garages, basements, kitchens, and dorm rooms.

LO 5-3

Advantages of Small-Business Ownership

There are many advantages to establishing and running a small business. These can be categorized into personal advantages and business advantages. Table 5.4 lists some of the traits that can help entrepreneurs succeed.

Independence

Independence is probably one of the leading reasons that entrepreneurs choose to go into business for themselves. Being a small-business owner means being your own boss. Many people start their own businesses because they believe they will do better for themselves than they could do by remaining with their current employer or by changing jobs. They may feel stuck on the corporate ladder and that no business would take them seriously enough to fund their ideas. Sometimes people who venture forth to start their own small business are those who simply cannot work for someone else. Such people may say that they just do not fit the "corporate mold."

More often, small-business owners just want the freedom to choose whom they work with, the flexibility to pick where and when to work, and the option of working in a family setting. The availability of the computer, copy machine, fax, and Internet has permitted many people to work at home. In the past, most of them would have needed the support that an office provides.

TABLE 5.4
10 Successful Traits of
Young Entrepreneurs

| | |
|-------------|------------|
| Intuitive | Persistent |
| Creative | Innovative |
| Productive | Frugal |
| Patient | Friendly |
| Charismatic | Fearless |

Source: Yan Susanto, "10 Successful Traits of Young Entrepreneurs," Retire @ 21, April 10, 2009, www.retireat21.com/blog/10-successful-traits-of-young-entrepreneurs (accessed March 17, 2011).

Costs

As already mentioned, small businesses often require less money to start and maintain than do large ones. Obviously, a firm with just 25 people in a small factory spends less money on wages and salaries, rent, utilities, and other expenses than does a firm employing tens of thousands of people in several large facilities. Rather than maintain the expense of keeping separate departments for accounting, advertising, and legal counseling, small businesses often hire other firms (sometimes small businesses themselves) to supply these services as they are needed. Additionally, small-business owners can sometimes rely on friends and family members to help them save money by volunteering to work on a difficult project.

Flexibility

With small size comes the flexibility to adapt to changing market demands. Small businesses usually have only one layer of management—the owners. Decisions therefore can be made and executed quickly. In larger firms, decisions about even routine matters can take weeks because they must pass through multiple levels of management before action is authorized. When Taco Bell introduces a new product, for example, it must first research what consumers want, then develop the product and test it before introducing it nationwide—a process that sometimes takes years. An independent snack shop, however, can develop and introduce a new product (perhaps to meet a customer's request) in a much shorter time.

Focus

Small firms can focus their efforts on a precisely defined market niche—that is, a specific group of customers. Many large corporations must compete in the mass market or for large market segments. Smaller firms can develop products for particular groups of customers or to satisfy a need that other companies have not addressed. For example, Hampton Creek, based in San Francisco, focuses on using technology to produce sustainable protein products. The company developed a new type of egg substitute made from plant materials. This concept is likely to attract vegetarians and consumers concerned with sustainability, but founder and CEO Josh Tetrick has bigger plans. His concept is not to focus solely on a niche industry; he believes the solutions discovered at Hampton Creek will eventually help solve food shortages through alternatives that do not place a strain on the environment.²¹ By targeting small niches or product needs, businesses can sometimes avoid competition from larger firms, helping them to grow into stronger companies.

Reputation

Small firms, because of their capacity to focus on narrow niches, can develop enviable reputations for quality and service. A good example of a small business with a formidable reputation is W. Atlee Burpee and Co., which has the country's premier bulb and seed catalog. Burpee has an unqualified returns policy (complete satisfaction or your money back) that demonstrates a strong commitment to customer satisfaction.

Disadvantages of Small-Business Ownership

The rewards associated with running a small business are so enticing that it's no wonder many people dream of it. However, as with any undertaking, small-business ownership has its disadvantages.

LO 5-4

High Stress Level

A small business is likely to provide a living for its owner, but not much more (although there are exceptions as some examples in this chapter have shown). There are ongoing worries about competition, employee problems, new equipment, expanding inventory, rent increases, or changing market demand. In addition to other stresses, small-business owners tend to be victims of physical and psychological stress. The small-business person is often the owner, manager, sales force, shipping and receiving clerk, bookkeeper, and custodian. Having to multitask can result in long hours for most small-business owners. Many creative persons fail, not because of their business concepts, but rather because of difficulties in managing their business.

High Failure Rate

Despite the importance of small businesses to our economy, there is no guarantee of success. Half of all new employer firms fail within the first five years.²² Restaurants are a case in point. Look around your own neighborhood, and you can probably spot the locations of several restaurants that are no longer in business.

Small businesses fail for many reasons (see Table 5.5). A poor business concept—such as insecticides for garbage cans (research found that consumers are not concerned with insects in their garbage)—will produce disaster nearly every time. Expanding a hobby into a business may work if a genuine market niche exists, but all too often people start such a business without identifying a real need for the goods or services. Other notable causes of small-business failure include the burdens imposed by government regulation, insufficient funds to withstand slow sales, and vulnerability to competition from larger companies. However, three major causes of small-business failure deserve a close look: undercapitalization, managerial inexperience or incompetence, and inability to cope with growth.

Entrepreneurs experience a great deal of independence but also a great deal of stress. Many fail.



| |
|---|
| 1. Underfunded (not providing adequate startup capital) |
| 2. Not understanding your competitive niche |
| 3. Lack of effective utilization of websites and social media |
| 4. Lack of a marketing and business plan |
| 5. If operating a retail store, poor site selection |
| 6. Pricing mistakes—too high or too low |
| 7. Underestimating the time commitment for success |
| 8. Not finding complementary partners to bring in additional experience |
| 9. Not hiring the right employees and/or not training them properly |
| 10. Not understanding legal and ethical responsibilities |

TABLE 5.5
Challenges in Starting a
New Business

Undercapitalization. The shortest path to failure in business is **undercapitalization**, the lack of funds to operate a business normally. Too many entrepreneurs think that all they need is enough money to get started, that the business can survive on cash generated from sales soon thereafter. But almost all businesses suffer from seasonal variations in sales, which make cash tight, and few businesses make money from the start. Many small rural operations cannot obtain financing within their own communities because small rural banks often lack the necessary financing expertise or assets sizable enough to counter the risks involved with small-business loans. Without sufficient funds, the best small-business idea in the world will fail.

undercapitalization
the lack of funds to operate a
business normally

Managerial Inexperience or Incompetence. Poor management is the cause of many business failures. Just because an entrepreneur has a brilliant vision for a small business does not mean he or she has the knowledge or experience to manage a growing business effectively. A person who is good at creating great product ideas and marketing them may lack the skills and experience to make good management decisions in hiring, negotiating, finance, and control. Moreover, entrepreneurs may neglect those areas of management they know little about or find tedious, at the expense of the business's success.

Inability to Cope with Growth. Sometimes, the very factors that are advantages for a small business turn into serious disadvantages when the time comes to grow. Growth often requires the owner to give up a certain amount of direct authority, and it is frequently hard for someone who has called all the shots to give up control. It has often been said that the greatest impediment to the success of a business is the entrepreneur. Similarly, growth requires specialized management skills in areas such as credit analysis and promotion—skills that the founder may lack or not have time to apply. The founders of many small businesses, including Dell Computers, found that they needed to bring in more experienced managers to help manage their companies through growing pains.

Poorly managed growth probably affects a company's reputation more than anything else, at least initially. And products that do not arrive on time or goods that are poorly made can quickly reverse a success. The principal immediate threats to small and mid-sized businesses include rising inflation, energy and other supply shortages or cost escalations, and excessive household and/or corporate debt.

Consider Ethics and Social Responsibility



The Differences between Successful Entrepreneurs and Fraudsters

What do Steve Jobs and Bernie Madoff have in common? One is a highly admired entrepreneur responsible for creating one of the most valuable brands in the world. The other is a criminal guilty of operating the largest Ponzi scheme in the United States. The outcomes of the two men could not be more different. However, there are surprising similarities in the characteristics of famous entrepreneurs and fraudsters.

For instance, fraudsters tend to be intelligent, creative, persuasive, and seemingly confident—all characteristics of many successful entrepreneurs. Bernie Madoff built his enterprise from the ground-up, much like Oprah Winfrey, Bill Gates, and Steve Jobs. Successful entrepreneurs and fraudsters often display what has been termed “fearless dominance.” Those that display fearless dominance demonstrate boldness, grace under pressure, charisma, and intelligence.

If fraudsters and entrepreneurs share so many characteristics, then what keeps entrepreneurs from becoming

fraudsters? One trait is empathy. Being able to sympathize and care about others’ well-being is lacking among fraudsters. Al Dunlap, former CEO of Sunbeam, was known for firing people and taking an aggressive approach to business. He was later implicated in accounting fraud. Another major characteristic is the ability to bounce back from failure. When Steve Jobs was ousted from Apple, he went on to found Pixar and later returned to save Apple from bankruptcy. When Bernie Madoff encountered financial difficulties, he covered them up through fraud.²³

Discussion Questions

1. What characteristics do fraudsters and successful entrepreneurs share?
2. What are some major differences in the personalities of fraudsters and successful entrepreneurs?
3. Why is a lack of empathy fairly common among fraudsters?

LO 5-5

Starting a Small Business

We’ve told you how important small businesses are, and why they succeed and fail, but *how do you go about* starting your own business in the first place? To start any business, large or small, you must have some kind of general idea. Sam Walton, founder of Walmart stores, had a vision of a discount retailing enterprise that spawned the world’s largest retailing empire and changed the way companies look at business. Next, you need to devise a strategy to guide planning and development in the business. Finally, you must make decisions about form of ownership, the financial resources needed, and whether to acquire an existing business, start a new one, or buy a franchise.

The Business Plan

A key element of business success is a **business plan**—a precise statement of the rationale for the business and a step-by-step explanation of how it will achieve its goals. The business plan should include an explanation of the business, an analysis of the competition, estimates of income and expenses, and other information. It should also establish a strategy for acquiring sufficient funds to keep the business going. Many financial institutions decide whether to loan a small business money based on its business plan. A good business plan should act as a guide and reference document—not a shackle that limits the business’s flexibility and decision-making ability. The business plan must be revised periodically to ensure that the firm’s goals and strategies adapt to changes in the environment. Business plans allow companies to assess market potential, determine price and manufacturing requirements, identify optimal distribution channels, and refine product selection. Two college students had

business plan

a precise statement of the rationale for a business and a step-by-step explanation of how it will achieve its goals

an innovative idea that prompted them to create a business plan. They recognized a need for people to get a hold of their personal medical information. The two developed the concept for a medical management company that helps clients locate their records and pitched it in the Rutgers Business Plan Competition. After winning the first prize of \$20,000, the students launched Opcura.com, started hiring employees, and began promoting their business.²⁴ The SBA website provides an overview of a plan for small businesses to use to gain financing. Appendix A presents a comprehensive business plan.

Forms of Business Ownership

After developing a business plan, the entrepreneur has to decide on an appropriate legal form of business ownership—whether it is best to operate as a sole proprietorship, partnership, or corporation—and to examine the many factors that affect that decision, which we explored in Chapter 4.


Financial Resources

The expression “it takes money to make money” holds especially true in developing a business enterprise. To make money from a small business, the owner must first provide or obtain money (capital) to get started and to keep it running smoothly. Even a small retail store will probably need at least \$50,000 in initial financing to rent space, purchase or lease necessary equipment and furnishings, buy the initial inventory, and provide working capital. Often, the small-business owner has to put up a significant percentage of the necessary capital. Few new business owners have a large amount of their own capital and must look to other sources for additional financing.

Equity Financing. The most important source of funds for any new business is the owner. Many owners include among their personal resources ownership of a home, the accumulated value in a life-insurance policy, or a savings account. A new business owner may sell or borrow against the value of such assets to obtain funds to operate a business. Additionally, the owner may bring useful personal assets—such as a computer, desks and other furniture, a car or truck—as part of his or her ownership interest in the firm. Such financing is referred to as *equity financing* because the owner uses real personal assets rather than borrowing funds from outside sources to get started in a new business. The owner can also provide working capital by reinvesting profits into the business or simply by not drawing a full salary.

Small businesses can also obtain equity financing by finding investors for their operations. They may sell stock in the business to family members, friends, employees, or other investors. For example, Harvard alumnus Katrina Lake created a website called Stitch Fix that uses algorithms and personal stylists

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Small-business owners often use debt financing from banks or the Small Business Administration to start their own organization.



Some of the advantages of small businesses include flexibility, lower startup costs, and perhaps most desirable, the ability to be your own boss.

venture capitalists persons or organizations that agree to provide some funds for a new business in exchange for an ownership interest or stock

low price and then sell the stock for a profit after the business has grown successful. Although these forms of equity financing have helped many small businesses, they require that the small-business owner share the profits of the business—and sometimes control, as well—with the investors.

Debt Financing. New businesses sometimes borrow more than half of their financial resources. Banks are the main suppliers of external financing to small businesses. On the federal level, the SBA offers financial assistance to qualifying businesses. They can also look to family and friends as sources for long-term loans or other assets, such as computers or an automobile, that are exchanged for an ownership interest in a business. In such cases, the business owner can usually structure a favorable repayment schedule and sometimes negotiate an interest rate below current bank rates. If the business goes bad, however, the emotional losses for all concerned may greatly exceed the money involved. Anyone lending a friend or family member money for a venture should state the agreement clearly in writing before any money changes hands.

The amount a bank or other institution is willing to loan depends on its assessment of the venture's likelihood of success and of the entrepreneur's ability to repay the loan. The bank will often require the entrepreneur to put up *collateral*, a financial interest in the property or fixtures of the business, to guarantee payment of the debt. Additionally, the small-business owner may have to provide personal property as collateral, such as his or her home, in which case the loan is called a *mortgage*. If the small business fails to repay the loan, the lending institution may eventually claim and sell the collateral or mortgage to recover its loss.

Banks and other financial institutions can also grant a small business a *line of credit*—an agreement by which a financial institution promises to lend a business a predetermined sum on demand. A line of credit permits an entrepreneur to take quick advantage of opportunities that require external funding. Small businesses may obtain funding from their suppliers in the form of a *trade credit*—that is, suppliers allow the business to take possession of the needed goods and services and pay for them at a later date or in installments. Occasionally, small businesses engage in *bartering*—trading their own products for the goods and services offered by other businesses. For example, an accountant may offer accounting services to an office supply firm in exchange for office supplies and equipment.

to develop sets, or “fixes,” of clothes based upon the consumer’s individual tastes. The fixes are mailed to the consumer, who pays for what she wants to keep and mails the rest back. Stitch Fix is meant to appeal to consumers who want to keep shopping simple and are turned off by the large number of choices on websites such as Amazon.com. Despite high shipping costs, Stitch Fix received \$12 million from a venture-capital firm. These investors believe Stitch Fix has significant potential to expand and be successful.²⁵ **Venture capitalists** are persons or organizations that agree to provide some funds for a new business in exchange for an ownership interest or stock. Venture capitalists hope to purchase the stock of a small business at a



ReFleece: A Simple but Sustainable Product

Sam Palmer and Jennifer Feller took a risk with their idea for a sustainable iPad case. They refinanced their home and took out a home equity loan for \$150,000 to found ReFleece in 2012, a business that uses up-cycled fleece as material for tablet cases. *Up-cycling* refers to reusing material without compromising its quality. Equipped with design experience and a concern for sustainability, Palmer and Feller partnered with Patagonia's Common Threads Initiative that brings in old consumer fleece to be recycled. ReFleece gets most of its raw materials from this program. The only new materials on these tablet cases are thread, snaps, and elastic. These sustainable tablet cases are manufactured in the United States, which helps the company save on costs. ReFleece is sold on Amazon, in Patagonia stores, and on refleece.com for \$25 to \$32, depending on the size of the case.

The entrepreneurs have been praised for their ability to create a useful product from old materials as well as for their commitment toward social responsibility. The company is a member of 1 percent for the Planet, donating 1 percent of its profits toward environmental nonprofits. ReFleece expects to earn \$150,000 in sales of sustainable tablet cases.²⁶

Discussion Questions

1. Why do you think a simple concept such as a tablet case made from up-cycled material became successful?
2. How were the ReFleece founders able to fund their startup company? What risks did they accept to make their idea into a reality?
3. How has the partnership with Patagonia likely affected ReFleece's sales?

Additionally, some community groups sponsor loan funds to encourage the development of particular types of businesses. State and local agencies may guarantee loans, especially to minority business people or for development in certain areas.

Approaches to Starting a Small Business

Starting from Scratch versus Buying an Existing Business. Although entrepreneurs often start new small businesses from scratch much the way we have discussed in this section, they may elect instead to buy an existing business. This has the advantage of providing a built-in network of customers, suppliers, and distributors and reducing some of the guesswork inherent in starting a new business from the ground up. However, an entrepreneur who buys an existing business also takes on any problems the business already has.

Franchising. Many small-business owners find entry into the business world through franchising. A license to sell another's products or to use another's name in business, or both, is a **franchise**. The company that sells a franchise is the **franchiser**. Dunkin' Donuts, Subway, and Jiffy Lube are well-known franchisers with national visibility. The purchaser of a franchise is called a **franchisee**.

The franchisee acquires the rights to a name, logo, methods of operation, national advertising, products, and other elements associated with the franchiser's business in return for a financial commitment and the agreement to conduct business in accordance with the franchiser's standard of operations. The initial fee to join a franchise varies greatly. In addition, franchisees buy equipment, pay for training, and obtain a mortgage or lease. The franchisee also pays the franchiser a monthly or annual fee based on a percentage of sales or profits. In return, the franchisee often receives building specifications and designs, site recommendations, management and accounting support, and perhaps most importantly, immediate name recognition. Visit the website of the International Franchise Association to learn more on this topic.

franchise

a license to sell another's products or to use another's name in business, or both

franchiser

the company that sells a franchise

franchisee

the purchaser of a franchise

TABLE 5.6
Fastest Growing and
Hottest New Franchises

| Top 10 Fastest Growing Franchises | Top 10 Hottest New Franchises |
|-----------------------------------|----------------------------------|
| Subway | Kona Ice |
| Jan-Pro Franchising Int'l. Inc. | Menchie's |
| 7-Eleven Inc. | Orange Leaf Frozen Yogurt |
| Vanguard Cleaning Systems | ShelfGenie Franchise Systems LLC |
| Liberty Tax Service | Bricks 4 Kidz |
| Chester's | Smashburger Franchising LLC |
| Jazzercise Inc. | Game Truck Licensing LLC |
| Jimmy John's Gourmet Sandwiches | Paul Davis Emergency Services |
| Dunkin' Donuts | Signal 88 Security |
| Anago Cleaning Systems | Mac Tools |

Sources: "2013 Fastest-Growing Franchise Rankings," Entrepreneur, www.entrepreneur.com/franchises/rankings/fastestgrowing-115162/2013,-1.html# (accessed April 10, 2014); "2013 New Franchise Rankings," Entrepreneur, www.entrepreneur.com/franchises/rankings/topnew-115520/2013,-1.html (accessed April 10, 2014).

The practice of franchising first began in the United States in the 19th century when Singer used it to sell sewing machines. The method of goods distribution soon became commonplace in the automobile, gasoline, soft drink, and hotel industries. The concept of franchising grew especially rapidly during the 1960s, when it expanded to diverse industries. Table 5.6 shows the 10 fastest growing franchises and the top 10 new franchises.

The entrepreneur will find that franchising has both advantages and disadvantages. Franchising allows a franchisee the opportunity to set up a small business relatively quickly, and because of its association with an established brand, a franchise outlet often reaches the break-even point faster than an independent business would. Franchisees commonly report the following advantages:

- Management training and support.
- Brand-name appeal.
- Standardized quality of goods and services.
- National and local advertising programs.
- Financial assistance.
- Proven products and business formats.
- Centralized buying power.
- Site selection and territorial protection.
- Greater chance for success.²⁷

However, the franchisee must sacrifice some freedom to the franchiser. Some shortcomings experienced by franchisees include:

- Franchise fees and profit sharing with the franchiser.
- Strict adherence to standardized operations.
- Restrictions on purchasing.

- Limited product line.
- Possible market saturation.
- Less freedom in business decisions.²⁸

Strict uniformity is the rule rather than the exception. Entrepreneurs who want to be their own bosses are often frustrated with the restrictions of a franchise.

Help for Small-Business Managers

Because of the crucial role that small business and entrepreneurs play in the U.S. economy, a number of organizations offer programs to improve the small-business owner's ability to compete. These include entrepreneurial training programs and programs sponsored by the SBA. Such programs provide small-business owners with invaluable assistance in managing their businesses, often at little or no cost to the owner.

Entrepreneurs can learn critical marketing, management, and finance skills in seminars and college courses. In addition, knowledge, experience, and judgment are necessary for success in a new business. While knowledge can be communicated and some experiences can be simulated in the classroom, good judgment must be developed by the entrepreneur. Local chambers of commerce and the U.S. Department of Commerce offer information and assistance helpful in operating a small business. National publications such as *Inc.* and *Entrepreneur* share statistics, advice, tips, and success/failure stories. Additionally, most urban areas have weekly business journals/newspapers that provide stories on local businesses as well as on business techniques that a manager or small business can use.

The SBA offers many types of management assistance to small businesses, including counseling for firms in difficulty, consulting on improving operations, and training for owner/managers and their employees. Among its many programs, the SBA funds Small Business Development Centers (SBDCs). These are business clinics, usually located on college campuses, that provide counseling at no charge and training at only a nominal charge. SBDCs are often the SBA's principal means of providing direct management assistance.

The Service Corps of Retired Executives (SCORE) and the Active Corps of Executives (ACE) are volunteer agencies funded by the SBA to provide advice for owners of small firms. Both are staffed by experienced managers whose talents and experience the small firms could not ordinarily afford. SCORE has more than 13,000 volunteers at 354 locations in the United States and has served more than 8.5 million small businesses.²⁹ The SBA also has organized Small Business Institutes (SBIs) on almost 500 university and college campuses in the United States. Seniors, graduate students, and faculty at each SBI provide onsite management counseling.

Finally, the small-business owner can obtain advice from other small-business owners, suppliers, and even customers. A customer may approach a small business it frequents with a request for a new product, for example, or a supplier may offer suggestions for improving a manufacturing process. Networking—building relationships and sharing information with colleagues—is vital for any businessperson, whether you work for a huge corporation or run your own small business. Communicating with other business owners is a great way to find ideas for dealing with employees and government regulation, improving processes, or solving problems. New technology is making it easier to network. For example, some states are establishing social networking sites for the use of their businesses to network and share ideas.

LO 5-6

The Future for Small Business³⁰

Although small businesses are crucial to the economy, their size and limited resources can make them more vulnerable to turbulence and change in the marketplace than large businesses. Next, we take a brief look at the demographic, technological, and economic trends that will have the most impact on small business in the future.

Demographic Trends

America's baby boom started in 1946 and ended in 1964. Many boomers are over 50, and in the next few years, millions more will pass that mark. The baby boomer generation represents 26 percent of Americans.³¹ This segment of the population is wealthy, but many small businesses do not actively pursue it. Some exceptions, however, include Gold Violin, which sells designer canes and other products online and through a catalog, and LifeSpring, which delivers nutritional meals and snacks directly to the customer. Industries such as travel, financial planning, and health care will continue to grow as boomers age. Many experts believe that the boomer demographic is the market of the future.

Another market with huge potential for small business is the echo boomers, also called millennials or Generation Y. Millennials number around 75 million and possess a number of unique characteristics. Born between the early 1980s and the early 2000s, this cohort is not solely concerned about money. Those that fall into this group are also concerned with advancement, recognition, and improved capabilities. They need direct, timely feedback and frequent encouragement and recognition. Millennials do well when training sessions combine entertainment with learning. Working remotely is more acceptable to this group than previous generations, and virtual communication may become as important as face-to-face meetings.³²

The Latino population is the biggest and fastest growing minority segment in the United States—and a lucrative market for businesses looking for ways to meet the segment's many needs.



| |
|-----------------------------------|
| 1. Austin, Texas |
| 2. Virginia Beach, Virginia |
| 3. Houston, Texas |
| 4. Colorado Springs, Colorado |
| 5. San Antonio, Texas |
| 6. Nashville, Tennessee |
| 7. Dallas-Fort Worth, Texas |
| 8. Raleigh-Durham, North Carolina |

TABLE 5.7
Most Business-Friendly
Cities

Source: "8 most business-friendly cities," CNN Money, 2013, <http://money.cnn.com/gallery/smallbusiness/2013/06/18/best-places-launch-cities/index.html> (accessed April 10, 2014).

Yet another trend is the growing number of immigrants living in the United States, who now represent about 16 percent of the population. If this trend continues, by 2050 nearly one in five Americans will be classified as immigrants. The Latino population, the nation's largest minority group, is expected to triple in size by 2050.³³

This vast group provides still another greatly untapped market for small businesses. Retailers who specialize in ethnic products, and service providers who offer bi- or multilingual employees, will find a large amount of business potential in this market. Table 5.7 ranks top cities in the United States for small businesses and startups.

Technological and Economic Trends

Advances in technology have opened up many new markets to small businesses. Undoubtedly, the Internet will continue to provide new opportunities for small businesses. Imgur is a photo-sharing hub filled with trivial and humorous photos. It has become popular as a meme site. The company generates income by posting display advertisements from movie studios and videogame publishers. It charges users of the site \$24 a year if they want features like unlimited data storage. Users do not have to register to show approval or disapproval of a photo. The company's users upload 1.5 million images every day and is becoming one of the most traveled to sites in the world—despite the fact that it only has 11 employees.³⁴

Technological advances and an increase in service exports have created new opportunities for small companies to expand their operations abroad. Changes in communications and technology can allow small companies to customize their services quickly for international customers. Also, free trade agreements and trade alliances are helping to create an environment in which small businesses have fewer regulatory and legal barriers.

In recent years, economic turbulence has provided both opportunities and threats for small businesses. As large information technology companies such as Cisco, Oracle, and Sun Microsystems had to recover from an economic slowdown and an oversupply of Internet infrastructure products, some smaller firms found new niche markets. Smaller companies can react quickly to change and can stay close to their

customers. While well-funded dot-coms were failing, many small businesses were learning how to use the Internet to promote themselves and sell products online. For example, arts and crafts dealers and makers of specialty products found they could sell their wares on existing websites, such as eBay. Service providers related to tourism, real estate, and construction also found they could reach customers through their own or existing websites.

Deregulation of the energy market and interest in alternative fuels and in fuel conservation have spawned many small businesses. Southwest Windpower Inc. manufactures and markets small wind turbines for producing electric power for homes, sailboats, and telecommunications. Solar Attic Inc. has developed a process to recover heat from home attics to use in heating water or swimming pools. As entrepreneurs begin to realize that worldwide energy markets are valued in the hundreds of billions of dollars, the number of innovative companies entering this market will increase. In addition, many small businesses have the desire and employee commitment to purchase such environmentally friendly products. New Belgium Brewing Company received the U.S. Environmental Protection Agency and Department of Energy Award for leadership in conservation for making a 10-year commitment to purchase wind energy. The company's employees unanimously agreed to cover the increased costs of wind-generated electricity from the employee profit-sharing program.

The future for small business remains promising. The opportunities to apply creativity and entrepreneurship to serve customers are unlimited. While large organizations such as Walmart, which has more than 2.1 million employees, typically must adapt to change slowly, a small business can adapt immediately to customer and community needs and changing trends. This flexibility provides small businesses with a definite advantage over large companies.

LO 5-7

Making Big Businesses Act “Small”

The continuing success and competitiveness of small businesses through rapidly changing conditions in the business world have led many large corporations to take a closer look at what makes their smaller rivals tick. More and more firms are emulating small businesses in an effort to improve their own bottom line. Beginning in the 1980s and continuing through the present, the buzzword in business has been to *downsize* or *right-size* to reduce management layers, corporate staff, and work tasks in order to make the firm more flexible, resourceful, and innovative. Many well-known U.S. companies, including IBM, Ford, Apple Computer, General Electric, Xerox, and 3M, have downsized to improve their competitiveness, as have German, British, and Japanese firms. Other firms have sought to make their businesses “smaller” by making their operating units function more like independent small businesses, each responsible for its profits, losses, and resources. Of course, some large corporations, such as Southwest Airlines, have acted like small businesses from their inception, with great success.

Trying to capitalize on small-business success in introducing innovative new products, more and more companies are attempting to instill a spirit of entrepreneurship into even the largest firms. In major corporations, **intrapreneurs**, like entrepreneurs, take responsibility for, or “champion,” the development of innovations of any kind *within* the larger organization.³⁵ Often, they use company resources and time to develop a new product for the company.

intrapreneurs

individuals in large firms who take responsibility for the development of innovations within the organizations

⊖ So You Want to Be an Entrepreneur or Small-Business Owner

In times when jobs are scarce, many people turn to entrepreneurship as a way to find employment. As long as there are unfulfilled needs from consumers, there will be a demand for entrepreneurs and small businesses. Entrepreneurs and small-business owners have been, and will continue to be, a vital part of the U.S. economy, whether in retailing, wholesaling, manufacturing, technology, or services. Creating a business around your idea has a lot of advantages. For many people, independence is the biggest advantage of forming their own small business, especially for those who do not work well in a corporate setting and like to call their own shots. Smaller businesses are also cheaper to start up than large ones in terms of salaries, infrastructure, and equipment. Smallness also provides a lot of flexibility to change with the times. If consumers suddenly start demanding new and different products, a small business is more likely to deliver quickly.

Starting your own business is not easy, especially in slow economic times. Even in a good economy, taking an idea and turning it into a business has a very high failure rate. The possibility of failure can increase even more when money is tight. Reduced revenues and expensive materials can hurt a small business more than a large one because small businesses have fewer resources. When people are feeling the pinch from rising food and fuel prices, they tend to cut back on other expenditures—which could potentially harm your small business. The increased cost of materials will also affect your bottom line. However, several techniques can help your company survive:

- Set clear payment schedules for all clients. Small businesses tend to be worse about collecting payments than large ones, especially if the clients are acquaintances. However, you need to keep cash flowing into the company in order to keep business going.

- Take the time to learn about tax breaks. A lot of people do not realize all of the deductions they can claim on items such as equipment and health insurance.
- Focus on your current customers, and don't spend a lot of time looking for new ones. It is far less expensive for a company to keep its existing customers happy.
- Although entrepreneurs and small-business owners are more likely to be friends with their customers, do not let this be a temptation to give things away for free. Make it clear to your customers what the basic price is for what you are selling and charge for extra features, extra services, etc.
- Make sure the office has the conveniences employees need—like a good coffee maker and other drinks and snacks. This will not only make your employees happy, but it will also help maintain productivity by keeping employees closer to their desks.
- Use your actions to set an example. If money is tight, show your commitment to cutting costs and making the business work by doing simple things like taking the bus to work or bringing a sack lunch every day.
- Don't forget to increase productivity in addition to cutting costs. Try not to focus so much attention on cost cutting that you don't try to increase sales.

In unsure economic times, these measures should help new entrepreneurs and small-business owners sustain their businesses. Learning how to run a business on a shoestring is a great opportunity to cut the fat and to establish lean, efficient operations.³⁶

⊖ Review Your Understanding

Define entrepreneurship and small business.

An entrepreneur is a person who creates a business or product and manages his or her resources and takes risks to gain a profit; entrepreneurship is the process of creating and managing a business to achieve desired objectives. A small business is one that is not dominant in its competitive area and does not employ more than 500 people.

Investigate the importance of small business in the U.S. economy and why certain fields attract small business.

Small businesses are vital to the American economy because they provide products, jobs, innovation, and opportunities. Retailing, wholesaling, services, manufacturing, and high technology attract small businesses because these industries are

relatively easy to enter, require relatively low initial financing, and may experience less heavy competition.

Specify the advantages of small-business ownership.

Small-business ownership offers some personal advantages, including independence, freedom of choice, and the option of working at home. Business advantages include flexibility, the ability to focus on a few key customers, and the chance to develop a reputation for quality and service.

Summarize the disadvantages of small-business ownership, and analyze why many small businesses fail.

Small businesses have many disadvantages for their owners such as expense, physical and psychological stress, and a high failure rate. Small businesses fail for many reasons: undercapitalization, management inexperience or incompetence, neglect, disproportionate burdens imposed by government regulation, and vulnerability to competition from larger companies.

Describe how you go about starting a small business and what resources are needed.

First, you must have an idea for developing a small business. Next, you need to devise a business plan to guide planning and development of the business. Then you must decide what form of business ownership to use: sole proprietorship, partnership, or corporation. Small-business owners are expected to provide some of the funds required to start their businesses, but funds also can be obtained from friends and family, financial institutions, other businesses in the form of trade credit, investors (venture capitalists), state and local organizations, and the Small Business Administration. In addition to loans, the Small Business Administration and other organizations offer counseling, consulting, and training services. Finally, you must decide

whether to start a new business from scratch, buy an existing one, or buy a franchise operation.

Evaluate the demographic, technological, and economic trends that are affecting the future of small business.

Changing demographic trends that represent areas of opportunity for small businesses include more elderly people as baby boomers age, a large group in the 11 to 28 age range known as echo boomers, millennials, or Generation Y, and an increasing number of immigrants to the United States. Technological advances and an increase in service exports have created new opportunities for small companies to expand their operations abroad, while trade agreements and alliances have created an environment in which small business has fewer regulatory and legal barriers. Economic turbulence presents both opportunities and threats to the survival of small businesses.

Explain why many large businesses are trying to “think small.”

More large companies are copying small businesses in an effort to make their firms more flexible, resourceful, and innovative, and generally to improve their bottom line. This effort often involves downsizing (reducing management layers, laying off employees, and reducing work tasks) and intrapreneurship, when an employee takes responsibility for (champions) developing innovations of any kind within the larger organization.

Assess two entrepreneurs’ plans for starting a small business.

Based on the facts given in “Solve the Dilemma” on page 168 and the material presented in this chapter, you should be able to assess the feasibility and potential success of Gray and McVay’s idea for starting a small business.

Revisit the World of Business

1. What are some likely reasons that Chobani Yogurt has become such a success?
2. Describe some of the challenges that Chobani is facing.
3. Why is it such an issue when a major retailer drops a product from its shelves?

Learn the Terms

business plan 156
 entrepreneurship 146
 franchise 159
 franchisee 159

franchiser 159
 intrapreneurs 164
 small business 147
 Small Business Administration (SBA) 147

undercapitalization 155
 venture capitalists 158

Check Your Progress

1. Why are small businesses so important to the U.S. economy?
2. Which fields tend to attract entrepreneurs the most? Why?
3. What are the advantages of starting a small business? The disadvantages?
4. What are the principal reasons for the high failure rate among small businesses?
5. What decisions must an entrepreneur make when starting a small business?
6. What types of financing do small entrepreneurs typically use? What are some of the pros and cons of each?
7. List the types of management and financial assistance that the Small Business Administration offers.
8. Describe the franchising relationship.
9. What demographic, technological, and economic trends are influencing the future of small business?
10. Why do large corporations want to become more like small businesses?

Get Involved

1. Interview a local small-business owner. Why did he or she start the business? What factors have led to the business's success? What problems has the owner experienced? What advice would he or she offer a potential entrepreneur?
2. Using business journals, find an example of a company that is trying to emulate the factors that make small businesses flexible and more responsive. Describe and evaluate the company's activities. Have they been successful? Why or why not?
3. Using the business plan outline in Appendix A, create a business plan for a business idea that you have. (A man named Fred Smith once did a similar project for a business class at Yale. His paper became the basis for the business he later founded: Federal Express!)

Build Your Skills

Creativity



Background

The entrepreneurial success stories in this chapter are about people who used their creative abilities to develop innovative products or ways of doing something that became the basis of a new business. Of course, being creative is not just for entrepreneurs or inventors; creativity is an important tool to help you find the optimal solutions to the problems you face on a daily basis. Employees rely heavily on their creativity skills to help them solve daily workplace problems.

According to brain experts, the right-brain hemisphere is the source of creative thinking; and the creative part of the brain

can “atrophy” from lack of use. Let’s see how much “exercise” you’re giving your right-brain hemisphere.

Task

1. Take the following self-test to check your Creativity Quotient.³⁷
2. Write the appropriate number in the box next to each statement according to whether the statement describes your behavior always (3), sometimes (2), once in a while (1), or never (0).

| | Always 3 | Sometimes 2 | Once in a While 1 | Never 0 |
|--|-------------|----------------|-------------------------|------------|
| 1. I am a curious person who is interested in other people's opinions. | | | | |
| 2. I look for opportunities to solve problems. | | | | |
| 3. I respond to changes in my life creatively by using them to redefine my goals and revising plans to reach them. | | | | |
| 4. I am willing to develop and experiment with ideas of my own. | | | | |
| 5. I rely on my hunches and insights. | | | | |
| 6. I can reduce complex decisions to a few simple questions by seeing the "big picture." | | | | |
| 7. I am good at promoting and gathering support for my ideas. | | | | |
| 8. I think further ahead than most people I associate with by thinking long term and sharing my vision with others. | | | | |
| 9. I dig out research and information to support my ideas. | | | | |
| 10. I am supportive of the creative ideas from my peers and subordinates and welcome "better ideas" from others. | | | | |
| 11. I read books and magazine articles to stay on the "cutting edge" in my areas of interest. I am fascinated by the future. | | | | |
| 12. I believe I am creative and have faith in my good ideas. | | | | |
| Subtotal for each column | | | | |
| | Grand Total | | | |

3. Check your score using the following scale:

- 30–36 High creativity. You are giving your right-brain hemisphere a regular workout.
- 20–29 Average creativity. You could use your creativity capacity more regularly to ensure against "creativity atrophy."

- 10–19 Low creativity. You could benefit by reviewing the questions you answered "never" in the above assessment and selecting one or two of the behaviors that you could start practicing.
- 0–9 Undiscovered creativity. You have yet to uncover your creative potential.

Solve the Dilemma

The Small-Business Challenge



Jack Gray and his best friend, Bruce McVay, decided to start their own small business. Jack had developed recipes for fat-free and low-fat cookies and muffins in an effort to satisfy his personal health needs. Bruce had extensive experience in managing food-service establishments. They knew that a startup company needs a quality product, adequate funds, a written business plan, some outside financial support, and a good promotion program. Jack and Bruce felt they had all of this and more and were ready to embark on their new low-fat cookie/muffin store. Each had \$35,000 to invest and with their homes and other resources, they had borrowing power of an additional \$125,000.

However, they still have many decisions to make, including what form or organization to use, how to market their product, and how to determine exactly what products to sell—whether just cookies and muffins or additional products.

Discussion Questions

- Evaluate the idea of a low-fat cookie and muffin retail store.
- Are there any concerns in connection with starting a small business that Jack and Bruce have not considered?
- What advice would you give Jack and Bruce as they start up their business?

Build Your Business Plan

Small Business, Entrepreneurship, and Franchising



Now you can get started writing your business plan! Refer to Guidelines for the Development of the Business Plan following Chapter 1, which provides you with an outline for your business plan. As you are developing your business plan, keep in mind that potential investors might be reviewing it. Or you might have plans to go to your local Small Business Development Center for an SBA loan.

At this point in the process, you should think about collecting information from a variety of (free) resources. For example, if

you are developing a business plan for a local business, product good, or service, you might want to check out any of the following sources for demographic information: your local Chamber of Commerce, Economic Development office, census bureau, or City Planning office.

Go on the Internet and see if there have been any recent studies done or articles on your specific type of business, especially in your area. Remember, you always want to explore any secondary data before trying to conduct your own research.

See for Yourself Videocase

Sonic—A Successful Franchise with an Old-Fashioned Drive-In Experience



For those who are nostalgic for the classic drive-in diner experience, the Sonic fast-food chain helps fill that need. Sonic offers customers a dose of nostalgia with its 1950s-style curbside speakers and carhop service. As the United States' largest drive-in fast-food chain, Sonic offers a unique and diverse menu selection that helps set it apart from a highly competitive fast-food franchise market. Founder Troy Smith launched the first Sonic Drive-In (known then as Top Hat Drive-In) in Shawnee, Oklahoma, in 1953 as a sole proprietorship. He later added a partner, Charlie Pappe, and eventually turned the business into a franchise.

Despite its traditional feel, the company has seized upon new trends and opportunities to secure more business. Customers at Sonic frequently eat in their cars or at tables outside the restaurant. However, Sonic has begun building indoor dining prototypes in colder areas to test whether this will entice more customers to eat at its locations. The prototype still makes use of the restaurant's traditional patio but encloses it to protect customers from the elements. So far, prototypes have been set up in 10 locations. Each of these restaurants maintains its carhop and drive-thru features in order to retain the "Sonic experience."

Today, Sonic is a publicly traded company and ranks as the 10th largest fast-food franchise in terms of sales revenue. Franchising is an appealing option for entrepreneurs looking to begin businesses without creating them from scratch. In the case of Sonic, when a franchisee purchases a franchise, he or she is getting a business that already has a national reputation and a national advertising campaign. The company also offers its franchisees tremendous support and training. As a pioneer, Troy Smith was required to innovate; as a Sonic franchisee, one steps into an already proven system.

That being said, successfully running a franchise is not easy. One entrepreneur who owns 22 Sonic franchises says the

franchisee's job is to ensure that each customer has the best experience possible, thereby making repeat visits more likely. To accomplish this, a franchisee must build his or her locations, purchase equipment, hire excellent employees, make certain the products live up to Sonic's reputation, maintain a clean, inviting facility, and much more. In order to run 22 franchises, the entrepreneur runs his locations as limited partnerships, ensuring that a managing partner is on site at each location to keep day-to-day operations running smoothly.

Some of Sonic's success may be attributed to its stringent requirements for selecting franchisees. Although franchisees must have excellent financial credentials and prior restaurant/entrepreneurial experience, the most important factor is that each franchisee fit into the Sonic culture. Sonic offers two types of franchises. The traditional franchise, which includes the full restaurant set-up, requires a total investment of between \$1.1 million and \$3 million. Franchisees are required to pay 2 to 5 percent in ongoing royalty fees and a franchise fee of \$45,000. A Sonic in a travel plaza, a mall food court, or a college campus are all examples of the nontraditional model. Because these set-ups do not include the drive-in and carhop features, initial investment is less. However, royalty and advertising fees still apply.

For entrepreneurs looking for limited risk, franchises like Sonic are great options. The advantages are abundant, as discussed earlier. There is a high failure rate among small businesses. Entering into a successful franchise significantly cuts down on the risk of failure, although a franchisee does have to watch for market saturation, poor location choice, and other determining factors. However, there are also disadvantages; chiefly, franchisees are often required to follow a strict model set by the franchiser. For instance, in addition to prior restaurant experience, Sonic requires its franchisees to be financially and operationally able to open two or more drive-ins. These types of requirements may make it difficult

for entrepreneurs who want to set their own terms. However, with Sonic's successful business model and brand equity, there is no shortage of individuals who would like to operate a Sonic franchise.³⁸

Discussion Questions

1. What is Sonic's competitive advantage over other fast-food franchises?

2. What are the advantages of becoming a Sonic franchisee?
3. What are the disadvantages of buying into the Sonic franchise?

You can find the related video in the Video Library in Connect. Ask your instructor how you can access Connect.

Team Exercise

Explore successful global franchises. Go to the companies' websites and find the requirements for applying for three franchises. The chapter provides examples of successful franchises. What do the companies provide, and what is expected to be provided by the franchiser? Compare and contrast each group's findings for the franchises researched. For example, at Subway, the franchisee is responsible for the initial franchise fee, finding locations, leasehold improvements

and equipment, hiring employees and operating restaurants, and paying an 8 percent royalty to the company and a fee into the advertising fund. The company provides access to formulas and operational systems, store design and equipment ordering guidance, a training program, an operations manual, a representative on-site during opening, periodic evaluations and ongoing support, and informative publications.

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