Modern Management Concepts and Skills 15th edition Certo Solutions Manual

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CHAPTER 2: MANAGEMENT AND ENTREPRENEURSHIP: HANDLING START-UPS AND NEW VENTURES

CHAPTER SUMMARY:

Chapter 2 begins the student's study of the entrepreneurship process and challenges managers' need to overcome. Students need to develop their entrepreneurial skills throughout their managerial career as companies evolve from their initial start up to success in an ever-changing environment.

CHAPTER LEARNING OBJECTIVES:

1. An understanding of the three stages of entrepreneurship
2. An overall appreciation for the opportunity concept and an understanding of the primary types of entrepreneurial opportunities
3. An understanding of how to identify opportunities
4. Insights regarding the key components of opportunity evaluation
5. An appreciation for the role of opportunity exploitation in the entrepreneurship process
6. Insights regarding the various types of financing available to entrepreneurs
7. An appreciation for how existing organizations use corporate entrepreneurship
8. An understanding of and appreciation for the role of social entrepreneurship in society

TARGET SKILLS:

Entrepreneurship Skill: involves the identification, evaluation, and exploitation of opportunities

CHAPTER OUTLINE:

This chapter is divided into eight sections:

1. *Fundamentals of Entrepreneurship*
2. *Financing Exploitation*
3. *Corporate Entrepreneurship*
4. *Social Entrepreneurship*

Fundamentals of Entrepreneurship:
This section of the chapter focuses on the definition of entrepreneurship.

- Entrepreneurship refers to the identification, evaluation, and exploitation of opportunities
- *Figure 2.1 in the text provides an illustration of the stages of the entrepreneurship process*
- Entrepreneurial opportunities are occasions to bring into existence new products and services that allow outputs to be sold at a price greater than their cost of production.
    - They exist when individuals are able to sell new products and services at a price that produces a profit
- Entrepreneurs do find it difficult to keep their new businesses going and growing
    - Research shows that approximately 20 percent of new businesses do not make it past the first two years, 40 percent do not make it past four years, and 50 percent do not make it past six years.
    - Table 2.1 displays the results of studies examining the failure rates of some new businesses.
- An entrepreneur is the individual who identifies, evaluates, and exploits the opportunities – Entrepreneurial teams are made up of a group of individuals taking on the start-up process together
    - Research shows organizations started by entrepreneurial teams tend to perform better than those started by individual entrepreneurs working by themselves
- Types of Opportunities
    - Opportunities arising from the creation of new products or services
    - Opportunities arising from the discovery of new geographical markets in which new customers will appreciate the new product or service
    - Opportunities arising from the creation or discovery of new raw materials or after discovering alternative uses for existing raw materials
    - Opportunities emerging from the discovery of new methods of production
    - Opportunities arising from new methods of organizing
    - Table 2.2 in the text summarizes and provides examples of each of these different types of opportunities
- Opportunity Identification
    - Opportunities do not appear in standard form
    - Individuals differ in their abilities to identify opportunities

- Factors helping determine whether individuals are able to identify opportunities
  - Entrepreneurial alertness
    - Individual's ability to notice and be sensitive to new information about objects, incidents, and patterns of behavior in the environment
  - Information asymmetry
    - Information individuals have access to
    - New information and old information
    - No two people share all of this information at the same time
  - Social networks
    - Individuals' patterns of social relationships
  - Cross-cultural experience
    - Research indicates that cross-cultural experience is positively associated with opportunity identification. As individuals gain cross-cultural experience, they have access to different types of existing products, services, and customer problems associated with new cultures.
- Together the four factors influence opportunity identification
- *Figure 2.2 in the text summarizes the four factors*

- Opportunity Evaluation
  - Occurs when an entrepreneur decides whether he or she has a good idea or a viable opportunity that will provide the desired outcomes
  - Evaluation can provide a challenge to entrepreneurs as they must be very honest with themselves
  - Feasibility analysis – helping entrepreneurs understand whether an idea is practical
  - Studies customer demands, industry structure, entrepreneur's ability to provide the new product or service
  - Entrepreneurial risk – likelihood and magnitude of the opportunity's downside loss
  - Downside loss – resources entrepreneur could lose if the opportunity does not succeed
  - Entrepreneurs are most likely to pursue opportunities with low levels of entrepreneurial risk
  - Factors impacting entrepreneur's risk perception
    - Law of small numbers
      - Relying on small samples of information to guide decisions
    - Illusion of control
      - Overestimating the extent to which entrepreneurs can control the outcome of an opportunity
- Opportunity Exploitation
  - Exploitation refers to the activities and investments that are committed to gain returns from the new product or service arising from the opportunity

- Activities and investments committed to gain returns from the new product or service arising from an opportunity
- Occurs when an entrepreneur determines the opportunity is worth pursuing
- When they believe that customers will value the new product or service – and thus provide market demand
- When they perceive they have support of important stakeholders
- When they perceive their management team is capable
- *Figure 2.3 in the text summarizes these factors*

Financing Exploitation:
This section of the chapter discusses the sources of external capital for entrepreneurs when they have chosen to exploit the opportunity due to their own personal lack of capital.

- Entrepreneurs choose to exploit their opportunity when they do not have the funds to do so themselves
- Three primary sources of external capital
    - Angel investors
        - Wealthy individuals who provide capital to new companies
        - Today, approximately 140,000 angel investors provide about $9 billion in capital to nearly 25,000 new ventures each year
        - Receive a portion of the firm's equity in return for their investment
    - Venture capitalists
        - Firms that raise money from investors and then use the money to make investments in new firms
        - Receive a portion of the firm's equity in return for their investment
    - Bank financing
        - When an entrepreneur obtains financing from a financial institution in the form of a loan
        - They are not investors – entrepreneurs need to repay the loans with interest

Corporate Entrepreneurship:
This section of the chapter discusses the fact that corporations can also identify, evaluate, and exploit opportunities.

- Corporate entrepreneurship involves the use of existing corporations to identify, evaluate, and exploit opportunities
- An individual or group of individuals in an existing corporation creates a new organization or instigates renewal or innovation within that corporation
- The existing corporation's assets, market position, or other resources are leveraged to establish the new organization
    - When corporate entrepreneurship results in new companies, these new companies often continue to work closely with the parent company
- Four general types
    - Sustained regeneration
        - Most frequently used type of corporate entrepreneurship
        - Occurs when firms develop new cultures, processes, or structures to support new product innovations in current markets as well as introduce existing products into new markets
    - Organizational rejuvenation
        - Improving a firm's ability to execute strategies and focus on new processes instead of new products
    - Strategic renewal
        - When firm attempts to alter its own competitive strategy
    - Domain definition
        - When firm proactively seeks to create a product market position that competitors have not recognized

Social Entrepreneurship:
This section of the chapter examines entrepreneurship in a social context.

- Commercial entrepreneurship – when individuals or corporations pursue entrepreneurial opportunities for the purpose of generating sales and profits
- Social entrepreneurship – recognition, evaluation, and exploitation of opportunities that create value as opposed to personal or shareholder wealth
- Social value – the basic, long-standing needs of society
    - Has little to do with profits
- How Do Commercial and Social Entrepreneurship Differ?
    - Mission
        - The entrepreneur's mission or purpose
        - Commercial entrepreneurs create profits
        - Social entrepreneurs create value for the public
    - Availability of resources
        - Social entrepreneurs face difficulties in attracting capital from angel investors, venture capitalists, and banks
        - Rely on donations as sources of funding

        - Rely on volunteers to help organizations fulfill their mission
    - Performance measurement
        - Commercial entrepreneurs focus on profits, shareholder wealth, revenues, and costs
        - Social entrepreneurs focus on performance measure not related to money
            - Number of meals served
            - Improved emotional state of someone who is homeless
- Success Factors in Social Entrepreneurship
    - Networks of relationships
        - Large social networks can help social entrepreneurs identity potential employees and volunteers
    - Capital base
        - Capital is important because they don't have access to venture capital and bank financing
        - Capital raised through donations and other funding sources is key to the success of the social entrepreneurs
    - Public's acceptance of the new venture
        - Influences the success of the organization
        - When a large segment of society supports the cause, the social entrepreneur is likely to obtain the funds and employees or volunteers needed for success

SUPPLEMENTARY IDEA FOR GROUP EXPERIENTIAL EXERCISE:

- ***Group Experiential Exercise – Social Entrepreneurs and Social Entrepreneurship***
    - *Muhammad Yunus is considered a social entrepreneur and Grameen Bank is considered a highly-successful nonprofit with social value for the communities it serves. Ask students to assemble in small groups of four to seven and have them discuss other social entrepreneurs and social enterprises that they may be aware of.*
    - *Ask each group to prepare a list of five things that makes the business a social enterprise and/or a nonprofit. How does it function? Where is the social value it delivers? Does it appear successful? What is the mission statement?*
    - *Have each group briefly present their social enterprise to the class.*

CLASS PREPARATION AND PERSONAL STUDY:

- Reflecting on Target Skill
    - *Students are asked to review the chapter's target skill and learning objectives to ensure they have acquired all pertinent information within the chapter*
- Know Key Terms
    - *Key terms are listed asking students to define each of the terms*
- Know How Management Concepts Relate

- *Students are presented with the following three essay questions and asked to answer each one completely and thoroughly.*
- 2-1 – Describe the differences between opportunity identification and opportunity exploitation.
  Opportunities first have to be identified by the entrepreneur and this is called opportunity identification. There are four factors that influence the ability of individuals to identify opportunities: entrepreneurial alertness, information asymmetry, social networks, and the ability to establish means-ends relationships.
  Opportunity exploitation occurs when an entrepreneur (or group of entrepreneurs) decides an opportunity is worth pursuing. When an entrepreneur, for example, decides customers would highly value a new product, exploitation entails all of those activities (i.e., marketing, production, etc.) needed to sell the new product to consumers.

  Learning Objective: LO2.1: An understanding of the three stages of entrepreneurship

- 2-2 – Describe the main components of social entrepreneurship, and describe how social entrepreneurship differs from commercial entrepreneurship.
  Social entrepreneurship, like commercial entrepreneurship, involves the recognition, evaluation, and exploitation of opportunities that create social value instead of personal or shareholder wealth. Social value refers to the basic long-standing needs of society such as providing food, shelter, or clothing. Social entrepreneurship's mission is to create value for the public while commercial entrepreneurship creates profits.

  Learning Objective: LO2.8: An understanding of and appreciation for the role of social entrepreneurship in society

- 2-3 – Describe the different types of corporate entrepreneurship and provide examples of each.
  Corporate entrepreneurship is the process whereby an individual or group of individuals in an existing corporation creates a new organization or develop something innovative within that corporation. There are four types of corporate entrepreneurship:
  (a) Sustained regeneration is where a company develops a new product, structure, or culture to support new product innovations in current markets as well as with existing products into new markets. Arm & Hammer sustained regeneration when it developed new uses for baking soda, such as toothpaste.
  (b) Organizational rejuvenation focuses on improving the firm's ability to execute strategies and focuses on new processes instead of new products. GE successfully rejuvenated itself by changing policies and procedures within the company to support innovation.

(c) Strategic renewal when a firm tries to change its own competitive strategy. Walmart is trying to do this by attracting affluent customers.
(d) Domain definition happens when a company proactively seeks to create a new market position that competitors haven't yet recognized. Amazon.com was the first to realize the opportunity of selling books online.

Learning Objective: LO2.7: An appreciation for how existing organizations use corporate entrepreneurship

Cases:

- **Professor Becomes Restaurateur**
  - **Case Discussion Notes:**
    - *"Professor Becomes Restaurateur" and its related Challenge Case Summary were written to help clarify the management concepts from this chapter.*
    - *Wilmington College professor, Steven Austin Stovall, created a business plan alongside his students for a restaurant in the small Ohio town of Wilmington, a town of 12,000 people.*
    - *In August 2013, Professor Stovall opened Austin's Casual Eatery, a 150-seat restaurant with a full-service bar.*
    - *A main focus of Austin's Casual Eatery was to assess the menu items that were selling and reassess—and possibly replace—the others.*

  - 2-4 – Discuss the opportunities that Steven Austin Stovall observed in the local restaurant market. How did he evaluate and exploit those opportunities? *Through a feasibility analysis and the steps of his business plan, Professor Stovall, discovered that mostly chain restaurants existed in his area. He chose to open to exploit this opportunity and open a restaurant with "real food" (rather than preprocessed or frozen dishes) that his customers came to appreciate.*

    Learning Objective: LO2.5: An appreciation for the role of opportunity exploitation in the entrepreneurship process

  - 2-5 – How risky was Stovall's move to change the entire concept of the restaurant just one week after opening? What could have gone wrong? *Students answers will vary but students will likely lean toward changing the concept being a risk. On the other hand, if the restaurant did not make necessary changes, it could have failed. Every business has the possibility of failure; Professor Stovall's was no exception.*

    Learning Objective: LO2.5: An appreciation for the role of opportunity exploitation in the entrepreneurship process

  - 2-6 – Describe Stovall's entrepreneurial alertness. How did it help or hurt his business?

Since the professor taught business courses and was well versed in business plans and opportunity exploitation, students will likely say his entrepreneurial alertness was more advanced than the average potential entrepreneur.

Learning Objective: LO2.5: An appreciation for the role of opportunity exploitation in the entrepreneurship process

- 2-7 – Which management employability skill or skills did Stovall demonstrate in this case?
  Students answers may vary, but collaboration appeared to be essential in this case. Stovall collaborated with his staff to make adjustments to menu items and the general concept of the restaurant.

  Learning Objective: LO2.5: An appreciation for the role of opportunity exploitation in the entrepreneurship process

- **How Part-Time Work Became a $40 Million Business Called Drybar**
  - **Case Discussion Notes:**
    - *Alli Webb identified an opportunity – providing only "blowouts," washing and blow-drying a client's hair offering a great look at a lower cost. People loved the idea, and soon Webb had more jobs than she could handle on her own, although she now admits that the earnings barely covered her costs.*
    - *Webb did persevere. The toughest management challenge she had was finding enough money to keep up with the growth in demand. Expansion came from forming a corporation, Drybar Holdings, and opening a shop in Brentwood, California. Webb and her husband did tap into their personal savings as well as approaching a family member for funds. They determined that the salon would need to attract at least 20 to 30 clients a day. Within the first few hours of opening, they were booked solid for the next six weeks.*
    - *The initial investment may have been only $250,000 but after funds from additional family and friends were invested, the total rose to $1 million. Continued success came from a $2.5 million investment from angel investors, and later $21 million from a private-equity firm. With this funding, Drybar has grown to 32 salons, $40 million in annual revenues, and 2,000 employees including stylists.*
    - *On average, the salon provides 60 to 100 blowouts every day, with many repeat customers who are willing to pay $40 for a 40-minute blowout appointment.*
    - *As Drybar grew, Webb's role has changed. She now uses her previous skill and knowledge as a stylist to establish and monitor standards for her employees. She has established detailed requirements for the design of each salon and the ways stylists should interact with their customers. Webb has clients face away from the mirror so they do not see their final*

style until it has been completed and they are then whirled in their chair to face the mirror. She has also created a line of hair care products.

- *She has also found the company's success has led to a new kind of risk. Competitors having seen the success at Drybar have entered the market. Webb's strategy is to continue focusing on high-quality service to maintain the advantage of being the first to enter the business.*

- 2-8 – What kind of opportunity did Alli Webb identify? How did entrepreneurial alertness, information asymmetry, and social networks shape her success?
  Alli Webb identified a new product or service opportunity. She was a hair stylist and identified a way to offer a service not typically provided in a salon. Individuals could come into the Drybar for a shampoo and style without the need for any cutting or color services.

  Webb demonstrated a high level of entrepreneurial alertness when she identified this service opportunity. She also had information asymmetry from her work in a salon and ability to have access to market information, plus her ability to observe services customers were looking for. As a hair stylist, Webb had an extended social network through her contacts with customers and other hair stylists. All of these factors combined have helped shape Webb's company and been major influences in its growth.

  Learning Objective: LO2.2: An overall appreciation for the opportunity concept and an understanding of the primary types of entrepreneurial opportunities

- 2-9 – What kinds of entrepreneurial risks has Webb faced? How will greater competition affect the level of risk?
  Webb faced risk from the lack of funding available to begin the company. Webb and her husband, along with her brother, were the initial investors in the company. Only after they had demonstrated proof of the company's viability and growth did they pursue loan and angel investor funding. They kept the risk in the family before being willing to provide a percentage of ownership to others.

  Learning Objective: LO2.4: Insights regarding the key components of opportunity evaluation

- 2-10 – What role has financing played in Drybar's success? What other sources of financing could Webb and her management team consider?
  The initial financing and later financing are what not only enabled Webb to begin her company, but also to grow the firm from one location to 32 salons with 2,000 employees.

  Learning Objective: LO2.6: Insights regarding the various types of financing available to entrepreneurs

Experiential Exercises:

- **Conducting a Feasibility Analysis**
  This is a good assignment to use as a group activity in class. Students are asked to offer their opinion of a friend's idea to open a new hair salon or barbershop on campus that would cater exclusively to students, faculty, and staff. She wants an opinion about the viability of the proposal.

  - Students are to prepare a one- to two-page feasibility analysis that answers the following questions: Is there a demand on campus for this business? Is there any competition? What qualifications would your friend need to be successful?

  In groups, have students discuss their answers. Ask them to respectfully debate the differences in their answers.

  Learning Objective: LO2.2: An overall appreciation for the opportunity concept and an understanding of the primary types of entrepreneurial opportunities

- **You and Your Career**
  Student responses will vary for this assignment. Students are asked to play the role of a hiring manager with two candidates from which to choose. They are asked to consider the following:
  - *Which is more attractive: a candidate with a traditional résumé of moving from job to job or one who has entrepreneurial experience?*

  Student responses will vary but most students will lean toward a candidate with entrepreneurial experience. Students should present a pros and cons list in favor of their argument.

  Learning Objective: LO2.2: An overall appreciation for the opportunity concept and an understanding of the primary types of entrepreneurial opportunities

- **Building Management Skills**
  KFC is looking to enhance their business. In particular, executives are worried that the company's focus on food means it is not making as much profit as it could if it increased sales of drinks. The managers are looking for students to identify, evaluate, and form methods of exploitation for the company regarding selling drinks. Students need to answer the following questions pertaining to the entrepreneurship process:

  - 2-11 – Identify a specific opportunity in the marketplace regarding drinks. It could be a new drink, a new line of drinks, a new type of retail outlet, or another type of opportunity.
    Student responses will vary. However, opportunities arise from the discovery of products, new retail opportunities, new geographical markets in which new customers will value the new product, or other new product ventures.

Learning Objective: LO2.3: An understanding of how to identify opportunities

- 2-12 – Evaluate this opportunity using feasibility analysis. In particular, focus on how customers might respond to the new opportunity, indicate how industry competitors are already exploiting this opportunity, and describe KFC's ability to exploit this opportunity.
  Student responses will vary. However, in a feasibility analysis, customer demands, the structure of the industry, and the entrepreneur's ability to provide the new product or service need to be studied. Although students will have many ideas, not all of them will be feasible and this analysis will help them better understand the likelihood that their opportunities will provide the resources required.

  Learning Objective: LO2.4: Insights regarding the key components of opportunity evaluation

- 2-13 – What specific steps should KFC take to exploit this opportunity? Does the company have enough money to follow your suggestion(s) easily, or should the company pursue financing options?
  Encourage students to go online to www.kfc.com to investigate the company's financial position.

  Learning Objective: LO2.5: An appreciation for the role of opportunity exploitation in the entrepreneurship process

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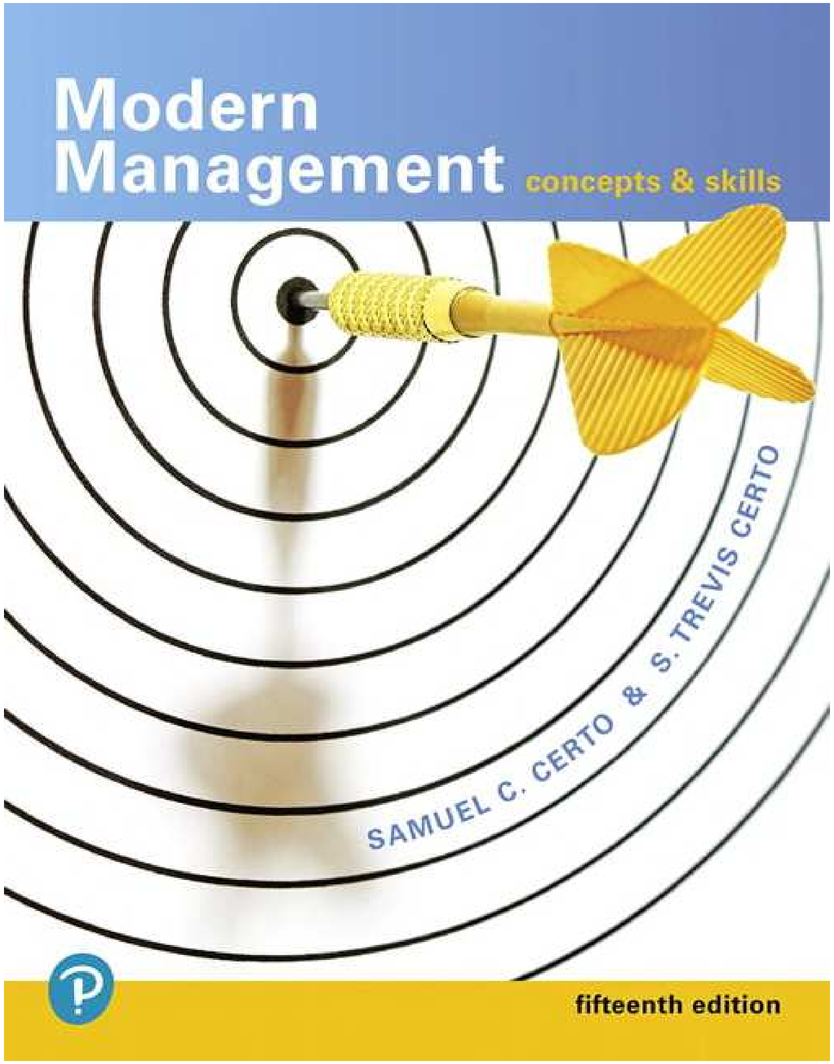


Chapter 2

Management and Entrepreneurship: Handling Start-Ups and New Ventures

Learning Objectives (1 of 2)

2.1 An understanding of the three stages of entrepreneurship

2.2 An overall appreciation for the opportunity concept and an understanding of the primary types of entrepreneurial opportunities

2.3 An understanding of how to identify opportunities

2.4 Insights regarding the key components of opportunity evaluation

Learning Objectives (2 of 2)

2.5 An appreciation for the role of opportunity exploitation in the entrepreneurship process

2.6 Insights regarding the various types of financing available to entrepreneurs

2.7 An appreciation for how existing opportunities use corporate entrepreneurship

2.8 An understanding of and appreciation for the role of social entrepreneurship in society

Fundamentals of Entrepreneurship

Entrepreneurship

- Identification—Evaluation—Exploitation of Entrepreneurial Opportunities

Entrepreneurial Opportunity

- An occasion to create new products or services that can be sold at a price greater than their cost of production

Entrepreneurship Process

Figure 2.1 Stages of the entrepreneurship process

Types of Opportunities (1 of 2)

Table 2.1 A Summary of Entrepreneurial Failure Rates

Operation	**Failure Rate**
New Restaurants	Approximately 51% of new restaurants fail within the first 5 years.
New Businesses	Approximately 60% of new businesses fail within the first 6 years.
New Chemical Plants	Approximately 80% of new chemical plants fail within the first 10 years.

Types of Opportunities (2 of 2)

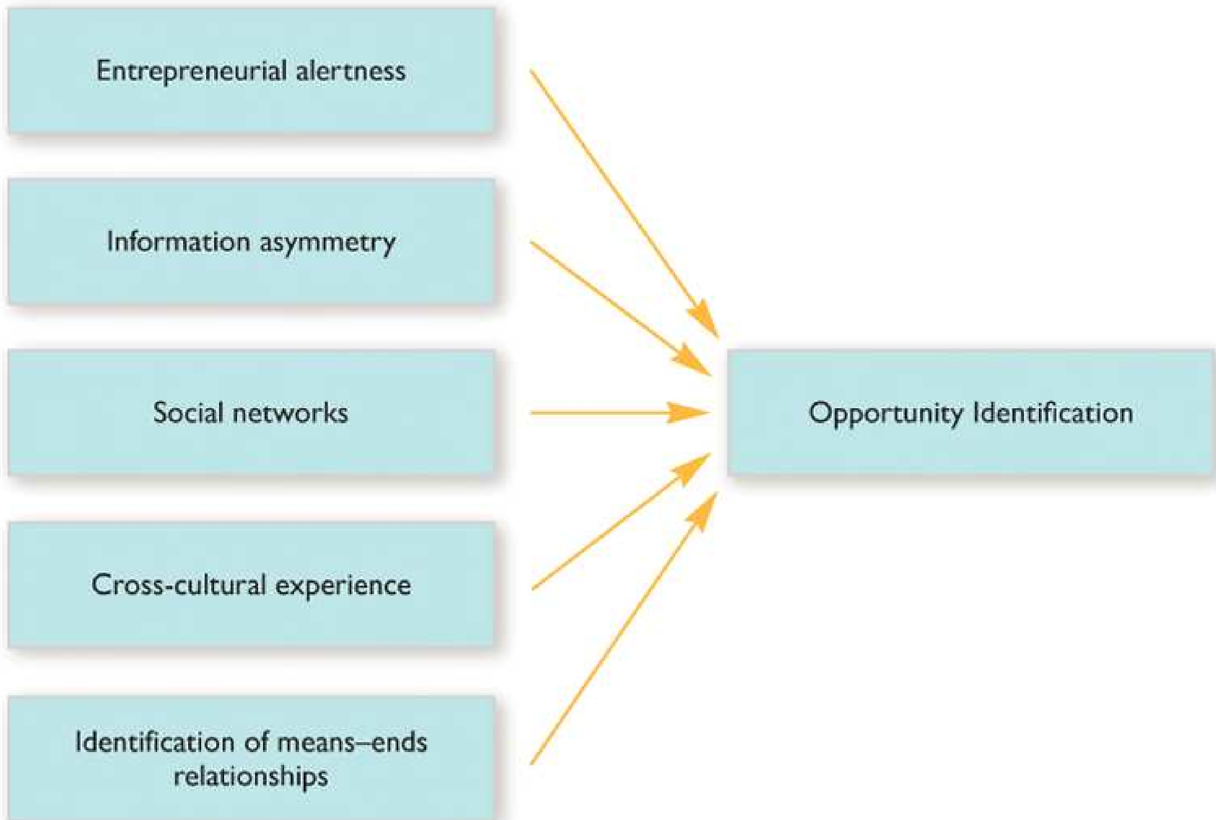
- **Five Types**
  - Creation of new products and services
  - Discovery of new geographical markets where new customers will appreciate new products or services
  - Creation or discovery of new raw materials or discovering alternative uses for existing raw materials
  - Discovery of new methods of production
  - New methods of organizing

Opportunity Identification (1 of 2)

- Entrepreneurs are not able to take advantage of opportunities unless they know they exist
- Nonstandard opportunities and individual differences lead to not everyone exploiting the same opportunities all at once
- Five factors determine whether individuals identify opportunities, refer to **Figure 2.2**

Opportunity Identification (2 of 2)

Figure 2.2 Determinants of opportunity identification



Opportunity Evaluation (1 of 2)

- Entrepreneur must determine if they have a good idea or viable opportunity to provide the desired outcomes
- **Feasibility Analysis**
  - A study of the practicality of an idea to support a business
- **Entrepreneurial Risk**
  - Law of Small Numbers
  - Illusion of Control

Opportunity Evaluation (2 of 2)

Two factors that influence the accuracy of an entrepreneur's risk perceptions

- **Law of Small Numbers**
  – Relying on small samples of information to make decisions
- **Illusion of Control**
  – Overestimating the extent to which an individual can control the outcome of an opportunity

Opportunity Exploitation

- **Activities and investments committed to gain returns from new products or services**
- Should exploit opportunity when
  - Customers will value new products or services AND they provide market demand
  - Perceive have support of important stakeholders
  - Perceive management team is capable

Financing Exploitation (1 of 2)

- **Internal Financing**
  - Entrepreneur’s own funds or credit cards
- **Three Forms of External Financing**
  - Angel Investors: Wealthy investors who provide capital to new companies
  - Venture Capitalists: Investment firms that supply funds to new ventures
  - Bank Financing: Financial institutions that offer loans to new companies

Financing Exploitation (2 of 2)

- **Important differences between forms of external financing**
  - Angel Investors and Venture Capitalist provide money in exchange for equity (ownership) in the company
  - Venture Capitalists tend to make large investments, while Angel Investors make smaller investments in industries where they have expertise
  - Banks are more interested in a firm’s ability to payback a loan, not the firm’s long-term potential for returns

Corporate Entrepreneurship (1 of 2)

- The process in which an individual, or group, creates a new organization within a corporation
- Corporate entrepreneurship can work in both new and established firms
- The organizations created during this process continue to work closely with “parent” company

Corporate Entrepreneurship (2 of 2)

- **Four general types of Corporate Entrepreneurship**
  - Sustained Regeneration
  - Organizational Rejuvenation
  - Strategic Renewal
  - Domain Definition

Social Entrepreneurship

- **Commercial versus Social Entrepreneurship**
  - **Commercial Entrepreneurship** Individuals or corporations pursue opportunities for the purpose of generating sales and profits
  - **Social Entrepreneurship** Recognition, evaluation, and exploitation of opportunities that create social value as opposed to personal or shareholder wealth

Commercial and Social Entrepreneurship Differences

- **Mission**
  - Profits versus value for the public
- **Availability of Resources**
  - External investing versus donations
- **Performance Measurement**
  - Quantitative measures (i.e. profit) versus social good

Success Factors in Social Entrepreneurship
(1 of 2)

- **Networks of Relationships**
  - Large networks provide sources of capital
  - Help to identify potential employees and volunteers
- **Capital**
  - Access to sources of capital are more important than to commercial firms
  - No access to investors or bank loans
  - Most funding is provided by donations

Success Factors in Social Entrepreneurship
(2 of 2)

- **Public's Acceptance of New Venture**
  - Depends on the entrepreneur's social values
  - The larger the segment of society supports the cause, the greater the access to funds and volunteers

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