

The background of the entire cover is an antique, sepia-toned map. It features a grid of latitude and longitude lines. Various geographical features are labeled, including 'Groenlandia' (Greenland), 'MARE DEL NORT' (North Sea), 'AFRICA', 'EUROPA', 'ASIA', 'INDIA', 'ARABIA', 'EGYPTUS', 'AFRICA', 'EUROPA', 'ASIA', 'INDIA', 'ARABIA', 'EGYPTUS'. Several wooden pushpins are pinned to the map: a black one near the top center, a light-colored one on the right side, a black one in the lower center, and a light-colored one in the bottom left corner. The map has a textured, aged appearance with some areas appearing torn or faded.

SECOND EDITION

Entrepreneurship

STRATEGIES AND RESOURCES

MARC J. DOLLINGER

SECOND EDITION



ENTREPRENEURSHIP

Strategies and Resources

Marc J. Dollinger

Indiana University

Prentice Hall, Upper Saddle River, New Jersey 07458

Acquisitions Editor: Stephanie Johnson
Editorial Assistant: Hersch Doby
Editor-in-Chief: Natalie Anderson
Marketing Manager: Tami Wederbrand
Production Coordinator: Maureen Wilson
Managing Editor: Dee Josephson
Manufacturing Buyer: Diane Peirano
Manufacturing Supervisor: Arnold Vila
Manufacturing Manager: Vincent Scelta
Design Manager: Patricia Smythe
Cover Design: Bruce Kenselaar
Cover Photo: Annabelle Breakey/Tony Stone Images
Composition: UG

Copyright © 1999 by Prentice-Hall, Inc.
Upper Saddle River, New Jersey 07458

All rights reserved. No part of this book may be reproduced, in any form or by any means, without written permission from the Publisher.

Library of Congress Cataloging-in-Publication Data

Dollinger, Marc J.

Entrepreneurship: strategies and resources / Marc J. Dollinger—
2nd ed.

p. cm.

Includes bibliographical references and index.

ISBN 0-13-745993-9

1. New business enterprises. 2. Entrepreneurship. I. Title.

HD62.5.065 1999

658.4'21—dc21

98-23829

CIP

Prentice-Hall International (UK) Limited, *London*
Prentice-Hall of Australia Pty. Limited, *Sydney*
Prentice-Hall Canada Inc., *Toronto*
Prentice-Hall Hispanoamericana, S.A., *Mexico*
Prentice-Hall of India Private Limited, *New Delhi*
Prentice-Hall of Japan, Inc., *Tokyo*
Pearson Education Asia Pte. Ltd., *Singapore*
Editora Prentice-Hall do Brasil, Ltda., *Rio de Janeiro*

Printed in the United States of America

10 9 8 7 6 5 4



ENTREPRENEURSHIP

Strategies and Resources



Preface

Since the publication of the first edition of *Entrepreneurship: Strategies and Resources*, the field of entrepreneurship has grown even faster than I would have predicted. There are more courses and schools teaching entrepreneurship than ever. The major business periodicals, *Business Week*, *Fortune*, and *Wall Street Journal* continue expanding their coverage of entrepreneurs and their companies. *Success* magazine has begun a ranking of top business school entrepreneurship programs. Business plan competitions at the graduate and undergraduate level continue to proliferate and the prizes get larger and larger. International interest in new venture creation has grown exponentially and some of this has been delivered through the internet in distance learning formats. I personally participated in one such effort between Indiana University and City University of Hong Kong. The technology enabled us to form joint ventures between students in the United States and Hong Kong for the purpose of starting businesses. It was marvelous.

In this second edition of *Entrepreneurship: Strategies and Resources*, I have tried to improve upon the foundation set in the first edition. This book is designed to be friendlier to the user, beginning with its new design and softcover. A number of new features will help make the text easier to read and understand. Dozens of new examples and mini-cases, called “Street Stories,” have been added. International examples and applications are integrated throughout the book.

Organization of the Book

Entrepreneurship: Strategies and Resources is organized into three parts. Part I introduces the major themes and theory of the book. Chapter 1 describes the roles that new venture creation plays in the international economy, defines entrepreneurship, and shows how three factors—individuals, environments, and organizations—come together to create the entrepreneurial event.

Chapter 2 sets this textbook apart from others because it casts entrepreneurial phenomena in terms of the predictive theory of the resource-based framework. In this chapter we present the basic concepts and model of the resource-based theory. There are six types of resources in our theory: financial, physical, technological, human, organizational, and reputational. The theory says that entrepreneurs can create sustainable competitive advantage for their ventures when they possess or can acquire and control resources that are rare, valuable, hard to duplicate, and nonsubstitutable. Here we emphasize the importance of human resources, especially the entrepreneur.

We then explain how these resources are a source of profit and rent for the entrepreneur and how the new venture needs to protect these rents and profits through isolating mechanisms and first mover advantages. Lastly, we offer a model of resource-based feasibility analysis to guide the student throughout the rest of the book.

Part II of *Entrepreneurship: Strategies and Resources* describes the environment for entrepreneurship. It presents the tools and techniques for analyzing business and competitive conditions and evaluating entrepreneurial opportunities. It is comparable to the strategy formulation phase of corporate strategic management. The purpose of this section is to show how the environment affects, directs, and impinges on the strategy formulation problem in new venture creation. It does this in two ways that can be expressed by the resource-based model: the environment helps determine what is rare, valuable, imitable, and substitutable **and** it is the source of resources that possess these four attributes. The strategy formulation problem in new venture creation can be stated as follows: What configuration of resources will provide the new firm with the best chances of achieving a competitive advantage?

Chapter 3 covers the aspects of the macro and micro environment that affect entrepreneurship and new venture creation. We present a process model for environmental analysis and then describe a six-element model of the macro environment: political, economic, technological, socio-demographic, and ecological factors. Next we offer the elements of the competitive environment. We incorporate the Porter Model (5-forces model) into the analysis. We begin by asking two questions of utmost importance to the entrepreneur in the early stages of new venture creation:

1. Is the industry the entrepreneur about to enter an attractive one?
2. What are the best ways to compete to increase the chances of creating a high profitability venture?

To address the first question, the chapter depicts an industry's profitability as a function of buyer and supplier power, the threat of substitutes, entry barriers, and the state of inter-firm rivalry. Students are shown how to do this analysis in sufficient depth and with limited data by resorting to the basics of microeconomic theory. To address the second question we discuss the ways that the possession and acquisition of the four-attribute resource-base provides the entrepreneur with tools to overcome strong industry forces and exploit weak industry forces. The resource-based model is incorporated into this discussion by demonstrating its applicability as a screening device for new venture ideas. We create and describe a resource-based implementation matrix—the four attributes of sustainable competitive advantage by the six types of resources: financial, physical, technological, reputational, human, and organizational resources.

Chapter 4 presents types of new venture strategies and examines different positions that entrepreneurs take regarding the resources required for their firms. We present the basic entry wedges available to the new venture and develop the set of resource-based strategies. We look at how the industry life cycle influences strategy choice. New ventures can be created successfully across the life cycle, but each poses its special challenges. The chapter concludes with an overview of strategic postures and orientations that entrepreneurs can take.

Chapter 5 presents the major tool for formulating and creating new ventures: the business plan. We offer an in-depth outline for a business plan, including all the key

sections and tips on how to structure the plan and the financial proposal for maximum effectiveness. The chapter continues with a discussion of the criteria and techniques for evaluating business plans. At the end of the chapter we offer proven tips for the format and presentation, writing, and editing of successful business plans.

Part III of *Entrepreneurship: Strategies and Resources* makes the transition from the formulation of entrepreneurial strategy to the implementation stage. The section covers strategic choice, implementation issues, and the problems of securing resources.

Chapter 6 discusses the implementation of a marketing strategy for the new venture. The special problems of marketing a new venture are covered. In addition, the traditional “4 Ps” of marketing are refocused as problems of resource acquisition: access to markets, products, channels of distribution, and creative promotional campaigns. Chapter 6 provides the link between market analysis and marketing. The chapter concludes with a series of methodologies that can be employed by entrepreneurs to make sales forecasts. We complete the chapter with a comprehensive case showing an example of effective sales forecasting for a start-up business.

Chapter 7 begins where Chapter 6 leaves off—the first element of any financial analysis begins with the top line, the sales forecasts. We discuss how financial resources can and cannot be a source of advantage for the new venture. Then we show how the venture can determine its financial and cash flow needs. After reviewing the types and sources of potential financing, we present three methods of new venture valuation. The chapter has two appendices: a case depicting the actual calculation of start-up expenses for a new venture, and a brief introduction into the process of going public.

Chapter 8 shows how entrepreneurs actually obtain investors and structure the financial deal. We look at the characteristics of various types of investors and how to appeal to their needs. The basic elements of the deal structure are presented, and then more advanced elements, such as phased financing and the use of options, are introduced. The chapter concludes with a review of the legal and tax issues raised by seeking outside investors. This chapter has an appendix describing the negotiable terms to a financial agreement.

Chapter 9 examines the creation and development of the organization. We begin with a discussion of the top management team and provide guidelines for effective top management processes. We do the same for boards of directors. Then we discuss the design of the new venture. The organizational design question is: What are the boundaries of the new venture? What things should the new venture do for itself and what things should it subcontract and procure on the market? Similarly, the physical resource question is: What things should the firm own for itself and which things should it lease or contract for? Both of these questions can be handled within the resource-based theory. Last we offer a vision of the entrepreneurial workplace. We discuss how culture, ethics, and personnel practices can help make organizations unique and therefore provide a competitive advantage.

Chapter 10 discusses corporate entrepreneurship (intrapreneurship) and the factors that lead to successful intrapreneurship and those that hinder large corporations from being entrepreneurial. The second section discusses franchising. We discuss what elements make a business concept a legitimate franchise opportunity, and what factors potential franchisees should evaluate before buying a franchise. For both sections we offer guidelines for effective decision making.

Pedagogic Features

The second edition of *Entrepreneurship: Strategies and Resources* provides several features that are designed to aid the learning process:

- **Chapter outlines** at the beginning of each chapter inform the students about what they should know about entrepreneurship when they complete the reading.
- **Chapter objectives** blueprint concepts the student should understand upon completion of the chapter.
- **E-Notes** capsule important entrepreneurship concepts for the student in a boxed format throughout each chapter.
- **Theory-based text** enables the student to analyze, evaluate, and predict the prospects for various business concepts and plans and make recommendations that increase the venture's chances.
- **Practical applications and guidelines** are offered in all the chapters to show the student how to deal with the real-world of entrepreneurs, markets, and competitors.
- **Street Stories** is the name of our boxed series of mini-cases. Each chapter contains these real-life examples drawn from the pages of the business press. Each Street Story illustrates the application of good theory to everyday new venture creation.
- **Tables and figures** throughout the book help illustrate difficult points and summarize the material for the student.
- **Extensive references** at the end of each chapter provide documentation for all of the arguments offered and enable the student to follow-up with additional reading.
- **End of chapter case and questions** provide the basis for stimulating discussion. Adapted from real situations described in the business press, these short cases are provocative illustrations of what can go right and what can go wrong in the process of new venture creation.
- **Key terms** are listed at the end of each chapter so that the student can be familiar with the language in use of entrepreneurship.
- **Chapter discussion questions** can provide the basis of classroom debate as well as be used for written assignments.
- **Chapter exercises** are designed for two purposes. The first is to aid the student in the development of his or her own business plan. The exercises guide the students to complete the portion of their plan covered in the chapter. Chapter exercises can also be used to complement the classroom experience by having the student go out into the business community to observe entrepreneurship first hand.
- **End of text cases** provide an in-depth learning exercise for the student. We have prepared 10 cases for analysis. The cases deal with the problems and opportunities of new venture creation, of securing resources, of building reputations, and of operating in a competitive market. The instructor's manual offers a comprehensive teaching note for each case.
- **Venture capital simulation** is a hands-on, multiple period, interpersonal team exercise that simulates the preparation, presentation, and negotiation of the terms of a venture capital investment. This gives the students the opportunity for personal and emotional learning, since the simulation produces much of the

same sort of tension, frustration, excitement, and exhilaration that entrepreneurs report. Detailed instructions on how to use the simulation and tips on making it a success are included in the instructor's manual.

- **Name and subject indexes** at the end of the book aid in finding topics and key people and companies.
- **State-of-the-art design** makes the book more readable and enhances learning.

Acknowledgments

As with the first edition, there are many people to thank for helping to bring this work together. From Prentice Hall there are major contributions and much support from my editor Stephanie Johnson, production manager Maureen Wilson, and Natalie Anderson who believed in the value of the book from the start.

I have been very fortunate to work for deans and department chairs who have supported my efforts. I thank Dean Dan Dalton and my Department Chair Harve Hegarty of the Kelley School of Business, Indiana University. I also thank Anne Tsui, the Department Head of Hong Kong University of Science and Technology, and Dean Ushio Sumita, Dean of International Management, International University of Japan.

A special thank you goes to my wife Mimi who helped with editing, proofreading, organizing materials, and wholehearted enthusiasm for the project.

Finally I would like to thank the reviewers of this book and the adopters of the first edition of the book for their many helpful comments and suggestions. All errors of commission and omission are mine alone.

Sol Ahliah, Buffalo State University
 John Butler, University of Washington
 William B. Gartner, University of Southern California
 Armand Gilinsky, Sonoma State University
 Charles Hofer, University of Georgia
 Roger Hutt, Arizona State University
 Jane Ives, University of Massachusetts
 Jack Kaplan, Columbia University
 Katherine Klein, University of Maryland
 Rahul Kochar, Metropolitan State College
 Dennis Logue, Amos Tuck School, Dartmouth University
 Walter W. Manley II, Florida State University
 Richard L. McCline, San Francisco State University
 Jim Nolen, University of Texas at Austin
 John O'Del, Averett College
 Jerry Osteryoung, Florida State University
 Thomas Parkinson, Northwestern University
 Edward Rogoff, Baruch College
 William R. Soukup, University of San Diego
 Justin Tan, California State University—San Marcos
 Warren C. Weber, California Polytechnic University—Pomona



About the Author

Marc J. Dollinger is Professor of Management in the School of Business, Indiana University. He is also a Fellow of Indiana University's Center for Entrepreneurship and Innovation. He received his PhD in Business and Economics from Lehigh University in 1983. Prior to receiving his doctorate, he was the Program Administrator of Lehigh's Small Business Development Center. Professor Dollinger conducts research in entrepreneurship and small business and teaches undergraduate and MBA entrepreneurship, venture growth management, new venture business planning, and small firm creativity and innovation classes. He has published articles in the *Academy of Management Journal*, *Academy of Management Review*, *Strategic Management Journal*, *Journal of Management*, *Entrepreneurship: Theory and Practice*, *Journal of Small Business Management*, and many others. He has served on the editorial review board of the *Academy of Management Review*, *Entrepreneurship: Theory and Practice*, *Journal of Small Business Management*, and the *Journal of Small Business Strategy*. In 1990, Professor Dollinger's research was recognized by the *Academy of Management Review* when he received the Best Paper Award. In 1993 he received the Alpha Kappa Psi award for Teaching Excellence in Management. He is a participant in the national Entrepreneurship Research Consortium, which is currently conducting the largest study of nascent entrepreneurs ever attempted. His students have frequently been finalists in national business plan competitions.



ENTREPRENEURSHIP

Strategies and

Resources



Brief Contents

Preface	xv
Chapter 1 A Framework for Entrepreneurship	1
Chapter 2 Resources and Capabilities	24
Chapter 3 The Environment for Entrepreneurship	52
Chapter 4 Entrepreneurial Strategies	91
Chapter 5 The Business Plan	131
Chapter 6 Marketing the New Venture	161
Chapter 7 Foundations of New Venture Finance	202
Chapter 8 Securing Investors and Structuring the Deal	240
Chapter 9 Creating the Organization	280
Chapter 10 Corporate Venturing, Networking, and Franchising	317
Case 1 Prolingua	355
Case 2 Fumero Artfabrics, Inc.	368
Case 3 e-station	385
Case 4 TV Answer: An Interactive Video Data Service	405
Case 5 Blitz	422
Case 6 Bright Ideas	453
Case 7 Rubio's: Home of the Fish Taco	485
Case 8 Suzy's Zoo	500
Case 9 Potatoquick!	509
Case 10 Windsor Industries, Inc.	528
Indexes	539



Contents

Preface xv

CHAPTER 1 A Framework for Entrepreneurship 1

Entrepreneurship and Your Future 2

What Is Entrepreneurship? 4

Creation 5

Economic organization 5

Risk and uncertainty 5

Where Is Entrepreneurship? 6

Economic growth and freedom 6

Around the world 8

The New Entrepreneur 9

Dimensions of Entrepreneurship 11

New venture creation 11

Resources, capabilities, and strategies 11

Individuals 15

Environment 15

Organizations 16

Organization of the Book 18

A Final Word 19

CHAPTER 2 Resources and Capabilities 24

Identifying Attributes of Strategic Resources 26

Valuable resources 28

Rare resources 28

Hard to copy resources 28

Nonsubstitutable resources 31

Resource Types 32

Physical resources 32

Reputational resources 32

Organizational resources 33

Financial resources 33

Intellectual and human resources 36

Technological resources 37

viii CONTENTS

A Psychological Approach	38
<i>Personality characteristics</i>	38
<i>Inadequacy of the trait approach</i>	39
A Sociological Approach	40
<i>Impetus for entrepreneurship</i>	40
<i>Situational characteristics</i>	44

CHAPTER 3 The Environment for Entrepreneurship 52

Schematic of the New Venture's Environment	53
Processes of Business Environment Analysis	55
<i>Scanning</i>	55
<i>Monitoring</i>	55
<i>Forecasting</i>	56
<i>Assessing</i>	57
Political and Governmental Analysis	57
<i>Stakeholder analysis</i>	57
<i>Global and international issues</i>	58
<i>National issues</i>	58
<i>State, regional, and local issues</i>	61
Macroeconomic Analysis	63
<i>Structural change</i>	63
<i>Cyclical change</i>	63
Technological Analysis	64
<i>Pure invention</i>	64
<i>Process innovation</i>	64
Sociodemographic Analysis	67
<i>Demographics</i>	67
<i>Social trends and values</i>	67
Ecological Analysis	68
Sources of Opportunity	69
<i>The unexpected</i>	69
<i>The incongruous</i>	69
<i>The process need</i>	69
<i>Industry and market structures</i>	70
<i>Demographics</i>	70
<i>Changes in perception</i>	70
<i>New knowledge</i>	70
<i>Competitive analysis</i>	71
Industry Analysis	72
Buyer Power	72
Supplier Power	76
The Threat of Substitutes	77

Entry Barriers	77
<i>Structural barriers to entry</i>	80
<i>Retaliatory barriers to entry</i>	80
<i>Price cutting</i>	80
<i>Legal challenges to new ventures</i>	81
Rivalry between Firms	81
Competitor Analysis	82
<i>Identifying the competition</i>	82
<i>Ranking competitors</i>	83

CHAPTER 4 Entrepreneurial Strategies 91

Entrepreneurship and Strategy	93
Entry Wedges	94
<i>Major wedges</i>	94
<i>Minor wedges</i>	97
Resource-Based Strategies	101
<i>Rent-seeking strategies</i>	102
Isolating Mechanisms and First-Mover Advantage	102
<i>Types of isolating mechanisms</i>	103
<i>Sources of first-mover advantage</i>	103
<i>Growth strategies</i>	104
<i>Quality as a strategy</i>	105
Strategy and Industry Environments	106
<i>Emerging industries</i>	107
<i>Transitional industries</i>	110
<i>Maturing industries</i>	113
<i>Declining industries</i>	115
<i>Fragmented industries</i>	117
Global Industries	118
<i>Sources of global momentum</i>	119
<i>Impediments to globalization</i>	121
Evaluating Strategy and Entrepreneurial Opportunities	121
<i>Stage 1: Identification</i>	122
<i>Stage 2: Capabilities</i>	123
<i>Stage 3: Competitive advantage</i>	124
<i>Stage 4: Strategy</i>	124
<i>Stage 5: Feedback</i>	124

CHAPTER 5 The Business Plan 131

Why Write a Business Plan?	133
<i>The costs of planning</i>	133
<i>The benefits of business planning</i>	133

x CONTENTS

Elements of the Business Plan	135
<i>Preliminary sections</i>	137
<i>Major sections</i>	141
<i>Concluding sections</i>	149
Critiquing the Plan: Questions Likely to Be Asked	152
<i>Management</i>	152
<i>Resources</i>	152
<i>Projections and returns</i>	154
<i>Exit</i>	154
Format and Presentation	155
<i>Physical appearance</i>	155
<i>Writing and editing</i>	155
<i>Prewriting</i>	156
<i>Writing and rewriting/revising</i>	156
<i>Editing</i>	156
CHAPTER 6 Marketing the New Venture	161
The Marketing and Entrepreneurship Interface	162
Marketing Concept and Orientation	164
<i>Customer orientation</i>	164
<i>Marketing research</i>	165
Marketing Strategy	172
<i>Selection of markets and segments</i>	173
<i>Marketing activities</i>	176
Sales Forecasting	187
CHAPTER 7 Foundations of New Venture Finance	202
Determining Financial Needs	204
<i>Working capital and cash flow management</i>	204
<i>Across the venture's life cycle</i>	209
<i>Start-up financing</i>	210
Sources of Financing	211
<i>Equity-based financing</i>	212
<i>Debt-based financing</i>	216
New Ventures Valuation	225
<i>Asset-based valuation</i>	225
<i>Earnings-based valuations</i>	226
<i>Discounted cash flow models</i>	229
CHAPTER 8 Securing Investors and Structuring the Deal	240
Approaching Investors	242
<i>The ideal investor</i>	243
<i>The ideal entrepreneur and new venture</i>	244
<i>Investor processes</i>	246

Structuring the Deal	252
<i>Segmenting the investor market</i>	252
<i>Risk sharing</i>	255
<i>Staged financing</i>	257
<i>The option to abandon</i>	257
<i>Warrants</i>	259
<i>Pitfalls and problems to avoid</i>	260
Legal and Tax Issues	261
<i>Legal forms of organization in the United States</i>	261
<i>Private placements under U.S. securities laws</i>	266
<i>U.S. bankruptcy laws</i>	267

CHAPTER 9 Creating the Organization 280

The Top Management Team	282
<i>Creating the top management team</i>	283
<i>Maintaining top management teams</i>	288
<i>The entrepreneur as personal leader</i>	289
Three Approaches to Leadership	290
<i>Benefits and pitfalls of TMTs</i>	292
<i>The board of directors</i>	293
<i>Guidelines for successful boards</i>	295
The Organization's Boundaries	297
<i>The virtual organization</i>	297
<i>Traditional organizational structure</i>	298
The Entrepreneurial Workplace	304
<i>The entrepreneurial culture</i>	304
<i>Entrepreneurial ethics</i>	306
<i>Most successful human resource practices</i>	308

CHAPTER 10 Corporate Venturing, Networking, and Franchising 317

Intrapreneurship	319
<i>The need for intrapreneurship</i>	319
<i>Comparison with entrepreneurship</i>	320
<i>The process of intrapreneurship</i>	322
<i>Opportunities and barriers to intrapreneurship</i>	326
<i>Guidelines for success</i>	327
Networking and Alliances	328
<i>Benefits and motivations for networking</i>	328
<i>Types of networks</i>	331
<i>Alliance behaviors</i>	332
<i>Partner selection criteria</i>	336
<i>Processes of reciprocity</i>	338
The Franchising Alternative	339
<i>Theoretical foundations</i>	340