



# New Business Ventures and the Entrepreneur

Third Edition

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# New Business Ventures and the Entrepreneur

*To*  
*Patrick Rooney Liles (1937–1983)*  
*teacher*  
*scholar of entrepreneurship*  
*business leader*  
*athlete*  
*friend*

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## Foreword

Entrepreneurship has come of age in the United States. In growing numbers, men and women of all ages are taking up careers in younger businesses, both startups and going concerns. On college campuses, it is now socially acceptable, even laudatory, to join an unknown company. Employment levels in larger companies have plateaued, even dipped. The tide is changing. This book is written to help those who want to participate directly in that change.

One element of the folklore of the times is that 9 out of 10 new businesses fail. While the statistic may have some historical validity, and may even be true today if every airport pretzel stand is included in the calculation, the folklore is misleading. The success rate for new businesses is much, much higher—over 50 percent—for companies that systematically take advantage of what is known today about making new ventures fly. This book pulls together and adds to the best of that knowledge. Building on the earlier work and format of the late Pat Liles, Howard Stevenson has developed a powerful teaching and learning device. The combination of truly interesting cases and concise, pertinent readings provides the necessary ingredients for a rich course on entrepreneurship at a time when the demand for such courses is increasing.

The team of Stevenson, Roberts, and Grousbeck is uniquely qualified to create this important work. They combine an exciting blend of successful, new venture operating experience and pedagogical prowess. They know whereof they write and teach. In addition, I sense in the fabric of the material a pervasive desire to be of real service to those who will guide our next generation of companies.

**Steven C. Brandt**  
Stanford University  
*Graduate School of Business*

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# Introduction

We have several objectives in writing this book. We believe that the topic of entrepreneurship is an exciting and important one. For those students of management who have decided to pursue a career as an entrepreneur, we think this book will provide some of the knowledge and skills required. For those who may be undecided, or perhaps committed to a more “traditional” career, many of the ideas in this book have value for those in more structured business settings. Executives are often called upon to deal with, and even to manage, entrepreneurs. Friends and acquaintances may contemplate starting new ventures and want the advice financial support of acquaintances in management positions.

Most importantly, we believe that all students of management have a great deal to learn from the study of entrepreneurship. The process of identifying and pursuing opportunity, the hallmark of the entrepreneur, has become increasingly important in restoring the competitive position of many U.S. industries in the international marketplace.

## ORGANIZATION AND CONTENTS

This book is organized into four parts:

- *Part I: Evaluating Opportunity and Developing the Business Concept.* This first section of the book serves as an overview, and also looks at the first two steps in the process of starting a new venture. Its first two chapters provide both a working definition of entrepreneurship and a framework for understanding the entrepreneurial process. Remaining chapters look at methods of valuing business opportunities as well as the process of preparing a business plan. The cases require evaluating business opportunities and formulating strategies to exploit opportunities.

- *Part II: Assessing and Acquiring Necessary Resources.* This part looks at two of the entrepreneur's critical steps—assessing required resources and acquiring those resources. The chapters focus on understanding and techniques for acquiring both financial and nonfinancial resources. The cases cover a variety of issues, including deal structure, securities law, venture capital, and intellectual property.
- *Part III: Acquiring an Existing Business.* In this part, we look at another avenue to an entrepreneurial career: purchasing an existing business. Chapters describe the search process, as well as some of the tax and legal dimensions of acquisitions. The cases look at several examples of individuals who attempt to purchase a business.
- *Part IV: Managing the Enterprise and Harvesting Value.* Here we look at some of the unique challenges of managing an entrepreneurial firm. Included are some approaches to harvesting the economic value that the entrepreneur has created. Chapters look at managing growth, and cover the problem of bankruptcy, and the process involved in a public offering. Cases focus on the operating problems of new ventures and the issue of managing growth in a rapidly expanding business.

Together, these sections trace the entrepreneurial process from the initial idea through business operations to harvest.

Throughout the book, we have exhibited some of our own biases. One of which we are aware has to do with the material that has been included as exhibits. Whenever possible, we have included actual documents: business plans, prospectuses, leases, laws, and legal opinions. While some of this material is detailed and highly specific, it is well worth the effort. This is the stuff of which real business is made; better to discover some of the subtleties of the tax code or lease provisions now than when you're sitting down to form a real venture.

Although the detail is included, please do not consider the technical notes, the exhibits, and the appendices as substitutes for detailed current investigation of law, regulation, markets, and practices. This is a rapidly evolving field. Although every effort has been made to be clear, current, and complete, you must consult good attorneys, accountants, and investments advisers before proceeding.

## ACKNOWLEDGMENTS

Patrick R. Liles taught the New Ventures course at Harvard from 1969 to 1977. In a very real sense, his early work in the field, his first edition of this book, and his vision of the entrepreneur provided a strong



foundation on which to build. We dedicate this book to Pat, both in recognition of his accomplishments and our respect for them, and out of our own sense of loss.

In addition to Pat's involvement with the course, many others participated in its teaching and development over the past 40 years. We are indebted to Myles Mace, Frank L. Tucker, Malcom Salter, Thomas Raymond, Philip Thurston, Jim Morgan, Richard Reese, Richard Von Werssowetz, John Van Slyke and Matt Weisman for building the New Ventures course at Harvard and providing a solid foundation for our own work. Many other students and scholars of entrepreneurship not at Harvard have contributed helpful comments: Jeffry Timmons, Barry Unger, Steve Brandt, Zenas Block, Karl Vesper, and Neil Churchill.

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The task of compiling this text was an arduous one. We wish to express our appreciation to the word processing staff, under the direction of Rose Giacobbe, who expertly typed and revised the manuscript. Audrey Barrett was extremely helpful in securing the permissions needed to complete the book.

We are indebted to the entrepreneurs who gave so willingly of their time, energy, and ideas so that we could collect this case material. They provide one of the most critical elements of entrepreneurial success: role models. Robert Reiss, Steve Belkin, Heather Evans, Bob Donadio, Joe Connolly, Bill Foster, Michael Bregmann, Kirk Reiding, Jamie Turner, Jim Southern, Vincent Lamb, Ralph Stayer, Bill Bowman, David Seuss and Howard Head are all real people who have shared their experiences with us; others have chosen to remain anonymous. To all we owe thanks for their cooperation. Ultimately, it is through the sharing of their experiences that we can learn.

Finally, each of us would like to make a more personal statement of thanks to our families:

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**M. J. R.**

- To my wife Sukey for her love, laughter, adaptability, and constant encouragement, and to my mother Emily for loving lessons of the value of integrity and hard work.

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# Evaluating Opportunity and Developing the Business Concept

In this first part of the book, we present, in Chapter 1, a framework for defining entrepreneurship. Following this, we look at the first two fundamental issues that the entrepreneur must address:

- Is this a good opportunity?
- What business strategy will most fully exploit the opportunity?

## **WHAT IS AN OPPORTUNITY?**

One of the entrepreneur's most important tasks is to identify opportunities. The capacity to creatively seek out opportunity is the starting point of entrepreneurship for both the individual and the firm.

In order to qualify as a good opportunity, the situation must meet two conditions:

1. It must represent a future state that is desirable.
2. It must be achievable.

Obviously, this issue cannot be addressed in isolation. It is difficult to understand how attractive an opportunity is until one has developed an idea of what the business strategy will be, what resources will be required to pursue the opportunity, how much those resources will cost, and, finally, how much value will be left over for the entrepreneur. Nonetheless, the step of evaluating the opportunity is the starting point for this thought process.

In Chapter 2, "The Start-Up Process," we describe the key steps in starting a business, as well as some of the analytical thinking that drives the decisions that must be made at each juncture.

Chapter 3, "Valuation Techniques," looks at some of the quantitative techniques for assessing the financial value of a business opportunity. It is important to remember, though, that there may be significant nonfinancial value in an opportunity that these techniques cannot measure. Some opportunities, for example, may not be worth much but may open doors to other opportunities that have considerable value. For some entrepreneurs, the opportunity to work on an interesting idea, with good people, and to be one's own boss compensates for what may be only a mediocre opportunity in a financial sense.

Chapter 4, "The Business Plan," describes the uses of a business plan and how you can write one to meet your needs, as well as those of potential investors.

## **DEVELOPING THE BUSINESS CONCEPT**

Once an opportunity is identified, the entrepreneur must develop a business concept and strategy to exploit the opportunity. Often, this strategy will proximately determine the success or failure of a business, even if the entrepreneur has identified a wonderful opportunity. Federal Express, for instance, decided to serve the same market that Emery Air Freight was serving. But Federal chose a much different strategy: a high fixed-cost hub system that was critically dependent on volume. Federal Express's strategy has allowed it to operate at lower costs and thus to surpass Emery in the express delivery market.

To maximize the odds of its success, a new venture should offer products or services that can profitably meet the needs of the markets it attempts to serve. But a new venture has an important advantage over an existing business. It can be created specifically to respond to market needs. Too often existing firms spend enormous resources searching for a market for the products or services produced by their operating assets.

## **THE CASES**

First Place is a good introductory case, in that it describes a typically difficult time for an aspiring entrepreneur: Having developed an idea for a business, Jack Paston tries to raise the money he needs to pursue his opportunity. R&R and Eastwind Trading are really "bookends." R&R describes the brief—but successful—history of a business, while Eastwind looks at two women contemplating an entrepreneurial career.

Tru-Paint and Commercial Fixtures both deal with the issue of assessing and valuing an opportunity. These cases point out the difficulty of trying to evaluate an opportunity in a vacuum; clearly, these businesses are attractive at some price. But, what exactly is that price? On what does it depend? Finally, ICEDELIGHTS provides an overview of the start-up process that raises a host of issues, including opportunity evaluation, resource assessment and acquisition, and valuation and financing.

# A Perspective on Entrepreneurship

The term *entrepreneurship* has entered the business vocabulary as the 1980s' equivalent of *professionalism*, the managerial buzzword of the 1970s. Many individuals aspire to be entrepreneurs, enjoying the freedom, independence, and wealth such a career seems to suggest. And larger corporations want to become more "entrepreneurial," their shorthand for the innovative and adaptive qualities they see in their smaller—and often more successful—competitors.

Our purpose in this chapter is to shed some light on the concept of entrepreneurship. We will define entrepreneurship as a management process and will discuss why we believe encouraging entrepreneurial behavior is critical to the long-term vitality of our economy. Finally, we will suggest that the practice of entrepreneurship is as important—if not more important—to established companies as it is to start-ups.

## INCREASING INTEREST IN ENTREPRENEURSHIP

It would be difficult to overstate the degree to which there has been an increase in the level of interest in entrepreneurship. A strong indicator of such interest is provided by the unprecedented rise in the rate of new business formation. The number of annual new business incorporations has doubled in the last 10 years, from annual rates of about 300,000 to over 600,000.

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These trends are mirrored in the capital markets that fund these start-ups. The decade 1975–1984 saw explosive growth in the amount of capital committed to venture capital firms in the United States. There was a concurrent dramatic increase in the amount of money raised in the public capital markets by young companies.

In addition to interest on the part of individuals who wish to become entrepreneurs and investors who wish to back them, there has been a wave of interest in what some refer to as *intrapreneurship*, or entrepreneurship in the context of the larger corporation. Building on the wealth of books and articles on the subject, some large firms seem to have recognized their shortcomings on certain critical dimensions of performance and have structured themselves in an attempt to be more innovative.

Indeed, we believe that the strengthening of entrepreneurship is a critically important goal of American society. The first 30 years of the postwar period in the United States were characterized by an abundance of opportunity, brought about by expanding markets, high investment in the national infrastructure, and mushrooming debt. In this environment, it was relatively easy to achieve business success, but this is no longer true. Access to international resources is not as easy as it once was; government regulation has brought a recognition of the full costs of doing business, many of which had previously been hidden; competition from overseas has put an end to American dominance in numerous industries; technological change has reduced product life in other industries; and so forth. In short, a successful firm is one that is either capable of rapid response to changes that are beyond its control or is so innovative that it contributes to change in the environment. Entrepreneurship is an approach to management that offers these benefits.

## DEFINING ENTREPRENEURSHIP

As we have discussed, there has been a striking increase in the level of attention paid to entrepreneurship. However, we've not yet defined what the term means.

As a starting point, it may be helpful to review some of the definitions scholars have historically applied to entrepreneurship. There are several schools of thought regarding entrepreneurship, which may roughly be divided into those that define the term as an economic function and those that identify entrepreneurship with individual traits.

The functional approach focuses on the role of entrepreneurship within the economy. In the 18th century, for instance, Richard Cantillon argued that entrepreneurship entailed bearing the risk of buying