

principles of

# Entrepreneurship

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## Introduction

Economists and business people differ in their definitions of entrepreneurship. Most, however, agree that entrepreneurship is vital for stimulating economic growth and employment opportunities in all societies. This is particularly true in the developing world, where successful small businesses are the primary engines of job creation and poverty reduction. This page introduces the first eight of what eventually will be a series of 21 one-page primers on the fundamentals of entrepreneurship. It discusses the essentials for building and running a business from the planning stages to marketing a product.

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### 1. What Is Entrepreneurship?

What is meant by entrepreneurship? The concept of entrepreneurship was first established in the 1700s, and the meaning has evolved ever since. Many simply equate it with starting one's own business. Most economists believe it is more than that.

To some economists, the entrepreneur is one who is willing to bear the risk of a new venture if there is a significant chance for profit. Others emphasize the entrepreneur's role as an innovator who markets his innovation. Still other economists say that entrepreneurs develop new goods or processes that the market demands and are not currently being supplied.

In the 20th century, economist Joseph Schumpeter (1883-1950) focused on how the entrepreneur's drive for innovation and improvement creates upheaval and change. Schumpeter viewed entrepreneurship as a force of "creative destruction." The entrepreneur carries out "new combinations," thereby helping render old industries obsolete. Established ways of doing business are destroyed by the creation of new and better ways to do them.

Business expert Peter Drucker (1909-2005) took this idea further, describing the entrepreneur as someone who actually searches for change, responds to it, and exploits change as an opportunity. A quick look at changes in communications – from typewriters to personal computers to the Internet – illustrates these ideas.

Most economists today agree that entrepreneurship is a necessary ingredient for stimulating economic growth and employment opportunities in all societies. In the developing world, successful small businesses are the primary engines of job

creation, income growth, and poverty reduction. Therefore, government support for entrepreneurship is a crucial strategy for economic development.

As the Business and Industry Advisory Committee to the Organization for Economic Cooperation and Development (OECD) said in 2003, "Policies to foster entrepreneurship are essential to job creation and economic growth." Government officials can provide incentives that encourage entrepreneurs to risk attempting new ventures. Among these are laws to enforce property rights and to encourage a competitive market system.

The culture of a community also may influence how much entrepreneurship there is within it. Different levels of entrepreneurship may stem from cultural differences that make entrepreneurship more or less rewarding personally. A community that accords the highest status to those at the top of hierarchical organizations or those with professional expertise may discourage entrepreneurship. A culture or policy that accords high status to the "self-made" individual is more likely to encourage entrepreneurship.

This overview is the first in a series of one-page essays about the fundamental elements of entrepreneurship. Each paper combines the thinking of mainstream economic theorists with examples of practices that are common to entrepreneurship in many countries. The series attempts to answer: Why and how do people become entrepreneurs? Why is entrepreneurship beneficial to an economy? How can governments encourage entrepreneurship, and, with it, economic growth?

## **2. What Makes Someone an Entrepreneur?**

**W**ho can become an entrepreneur? There is no one definitive profile. Successful entrepreneurs come in various ages, income levels, gender, and race. They differ in education and experience. But research indicates that most successful entrepreneurs share certain personal attributes, including: creativity, dedication, determination, flexibility, leadership, passion, self-confidence, and "smarts."

- Creativity is the spark that drives the development of new products or services, or ways to do business. It is the push for innovation and improvement. It is continuous learning, questioning, and thinking outside of prescribed formulas.
- Dedication is what motivates the entrepreneur to work hard, 12 hours a day or more, even seven days a week, especially in the beginning, to get the endeavor off the ground. Planning and ideas must be joined by hard work to succeed. Dedication makes it happen.

- Determination is the extremely strong desire to achieve success. It includes persistence and the ability to bounce back after rough times. It persuades the entrepreneur to make the 10th phone call, after nine have yielded nothing. For the true entrepreneur, money is not the motivation. Success is the motivator; money is the reward.
- Flexibility is the ability to move quickly in response to changing market needs. It is being true to a dream while also being mindful of market realities. A story is told about an entrepreneur who started a fancy shop selling only French pastries. But customers wanted to buy muffins as well. Rather than risking the loss of these customers, the entrepreneur modified her vision to accommodate these needs.
- Leadership is the ability to create rules and to set goals. It is the capacity to follow through to see that rules are followed and goals are accomplished.
- Passion is what gets entrepreneurs started and keeps them there. It gives entrepreneurs the ability to convince others to believe in their vision. It can't substitute for planning, but it will help them to stay focused and to get others to look at their plans.
- Self-confidence comes from thorough planning, which reduces uncertainty and the level of risk. It also comes from expertise. Self-confidence gives the entrepreneur the ability to listen without being easily swayed or intimidated.
- "Smarts" is an American term that describes common sense joined with knowledge or experience in a related business or endeavor. The former gives a person good instincts, the latter, expertise. Many people have smarts they don't recognize. A person who successfully keeps a household on a budget has organizational and financial skills. Employment, education, and life experiences all contribute to smarts.

Every entrepreneur has these qualities in different degrees. But what if a person lacks one or more? Many skills can be learned. Or, someone can be hired who has strengths that the entrepreneur lacks. The most important strategy is to be aware of strengths and to build on them.

### **3. Why Become an Entrepreneur?**

**W**hat leads a person to strike out on his own and start a business? Perhaps a person has been laid off once or more. Sometimes a person is frustrated with his or her current job and doesn't see any better career prospects on the horizon. Sometimes a person realizes that his or her job is in jeopardy. A firm may be contemplating cutbacks that could end a job or limit career or salary prospects. Perhaps a person already has been passed over for promotion. Perhaps a person sees no opportunities in existing businesses for someone with his or her interests and skills.

Some people are actually repulsed by the idea of working for someone else. They object to a system where reward is often based on seniority rather than accomplishment, or where they have to conform to a corporate culture.

Other people decide to become entrepreneurs because they are disillusioned by the bureaucracy or politics involved in getting ahead in an established business or profession. Some are tired of trying to promote a product, service, or way of doing business that is outside the mainstream operations of a large company.

In contrast, some people are attracted to entrepreneurship by the advantages of starting a business. These include:

- Entrepreneurs are their own bosses. They make the decisions. They choose whom to do business with and what work they will do. They decide what hours to work, as well as what to pay and whether to take vacations.
- Entrepreneurship offers a greater possibility of achieving significant financial rewards than working for someone else.
- It provides the ability to be involved in the total operation of the business, from concept to design and creation, from sales to business operations and customer response.
- It offers the prestige of being the person in charge.
- It gives an individual the opportunity to build equity, which can be kept, sold, or passed on to the next generation.
- Entrepreneurship creates an opportunity for a person to make a contribution. Most new entrepreneurs help the local economy. A few – through their innovations – contribute to society as a whole. One example is entrepreneur Steve Jobs, who co-founded Apple in 1976, and ignited the subsequent revolution in desktop computers.

Some people evaluate the possibilities for jobs and careers where they live and make a conscious decision to pursue entrepreneurship.

No one reason is more valid than another; none guarantee success. However, a strong desire to start a business, combined with a good idea, careful planning, and hard work, can lead to a very engaging and profitable endeavor.

#### **4. Decisions and Downfalls**

**E**ntrepreneurship is an attractive career choice. But many decisions have to be made before launching and managing a new business, no matter its size. Among the questions that need to be answered are:

- Does the individual truly want to be responsible for a business?

- What product or service should be the basis of the business?
- What is the market, and where should it be located?
- Is the potential of the business enough to provide a living wage for its employees and the owner?
- How can a person raise the capital to get started?
- Should an individual work full or part time to start a new business? Should the person start alone or with partners?

Answers to these questions are not empirically right or wrong. Rather, the answers will be based on each entrepreneur's judgment. An entrepreneur gathers as much information and advice as possible before making these and other crucial decisions.

The entrepreneur's challenge is to balance decisiveness with caution – to be a person of action who does not procrastinate before seizing an opportunity – and at the same time, to be ready for an opportunity by having done all the preparatory work possible to reduce the risks of the new endeavor.

Preparatory work includes evaluating the market opportunity, developing the product or service, preparing a good business plan, figuring out how much capital is needed, and making arrangements to obtain that capital.

Through careful analysis of entrepreneurs' successes and failures, economists have identified key factors for up-and-coming business owners to consider closely. Taking them into account can reduce risk. In contrast, paying them no attention can precipitate the downfall of a new enterprise.

- **Motivation:** What is the incentive for starting a business? Is it money alone? True, many entrepreneurs achieve great wealth. However, money is almost always tight in the startup and early phases of a new business. Many entrepreneurs do not even take a salary until they can do so and still leave the firm with a positive cash flow.
- **Strategy:** What is the strategy for distinguishing the product or service? Is the plan to compete solely on the basis of selling price? Price is important, but most economists agree that it is extremely risky to compete on price alone. Large firms that produce huge quantities have the advantage in lowering costs.
- **Realistic Vision:** Is there a realistic vision of the enterprise's potential? Insufficient operating funds are the cause of many failed businesses. Entrepreneurs often underestimate start-up costs and overestimate sales revenues in their business plans. Some analysts advise adding 50 percent to final cost estimates and reducing sales projections. Only then can the entrepreneur examine cash flow projections and decide if he or she is ready to launch a new business.

## 5. Go It Alone or Team Up?

One important choice that new entrepreneurs have to make is whether to start a business alone or with other entrepreneurs. They need to consider many factors, including each entrepreneur's personal qualities and skills and the nature of the planned business.

In the United States, for instance, studies show that almost half of all new businesses are created by teams of two or more people. Often the people know each other well; in fact, it is common for teams to be spouses.

There are many advantages to starting a firm with other entrepreneurs. Team members share decision-making and management responsibilities. They can also give each other emotional support, which can help reduce individual stress.

Companies formed by teams have somewhat lower risks. If one of the founders is unavailable to handle his or her duties, another can step in.

Team interactions often generate creativity. Members of a team can bounce ideas off each other and "brainstorm" solutions to problems.

Studies show that investors and banks seem to prefer financing new businesses started by more than one entrepreneur. This alone may justify forming a team.

Other important benefits of teaming come from combining monetary resources and expertise. In the best situations, team members have complementary skills. One may be experienced in engineering, for example, and the other may be an expert in promotion.

In general, strong teams have a better chance at success. In *Entrepreneurs in High Technology*, Professor Edward Roberts of the Massachusetts Institute of Technology (MIT) reported that technology companies formed by entrepreneurial teams have a lower rate of failure than those started by individuals. This is particularly true when the team includes a marketing expert.

Entrepreneurs of different ages can create complementary teams also. Optimism and a "can-do" spirit characterize youth, while age brings experience and realism. In 1994, for example, Marc Andreessen was a talented young computer scientist with an innovative idea. James Clark, the founder and chairman of Silicon Graphics, saw his vision. Together they created Netscape Navigator, the Internet-browsing computer software that transformed personal computing.

But entrepreneurial teams have potential disadvantages as well. First, teams share ownership. In general, entrepreneurs should not offer to share ownership unless the potential partner can make a significant contribution to the venture.

Teams share control in making decisions. This may create a problem if a team member has poor judgment or work habits.

Most teams eventually experience serious conflict. This may involve management plans, operational procedures, or future goals. It may stem from an unequal commitment of time or a personality clash. Sometimes such conflicts can be resolved; in others, a conflict can even lead to selling the company or, worse, to its failure.

It is important for a new entrepreneur to be aware of potential problems while considering the advantages of working with other entrepreneurs. In general, however, the benefits of teaming outweigh the risks.

## **6. Choosing a Product and a Market**

**A** prospective entrepreneur needs to come up with a good idea. This will serve as the foundation of the new venture.

Sometimes an entrepreneur sees a market need and – Eureka! – has an idea for a product or service to fill it. Other times an entrepreneur gets an idea for a product or service and tries to find a market for it. A Scottish engineer working at General Electric created putty that bounces but had no use for it. In the hands of a creative entrepreneur, it became a toy, "Silly Putty," with an enthusiastic market: children.

The idea doesn't have to be revolutionary. Research, timing, and a little luck transform commonplace ideas into successful businesses. In 1971, Chuck Burkett launched a firm to make an ordinary product, novelty key chains. But when he got a contract with a new venture in Florida – Disney World – he started making Mickey Mouse key chains, and achieved tremendous success.

There are many ways to look for ideas. Read a lot, talk to people, and consider questions such as: What limitations exist in current products and services? What would you like that is not available? Are there other uses for new technology?

What are innovative ways to use or to provide existing products? In Australia in 1996, two entrepreneurs founded Aussie Pet Mobile Inc. to bring pet bathing and grooming to busy people's homes. It is now a top U.S. franchise business.

Is society changing? What groups have unfulfilled needs? What about people's perceptions? Growing demand for healthy snacks created many business opportunities in the United States, for example.

Business ideas usually fit into one of four categories that were described by H. Igor Ansoff in the *Harvard Business Review* in 1957:

- An existing good or service for an existing market. This is a difficult approach for a start-up operation. It means winning over consumers through merchandising appeal, advertising, etc. Entry costs are high, and profit is uncertain.
- A new good or service for a new market. This is the riskiest strategy for a new firm because both the product and the market are unknown. It requires the most research and planning. If successful, however, it has the most potential for new business and can be extremely profitable.
- A new good or service for an existing market. (Often this is expanded to include modified goods/services.) For example, entrepreneurial greeting-card makers use edgy humor and types of messages not produced by Hallmark or American Greetings – the major greeting-card makers – to compete in an existing market.
- An existing good or service for a new market. The new market could be a different country, region, or market niche. Entrepreneurs who provide goods/services at customers' homes or offices, or who sell them on the Internet, are also targeting a new market – people who don't like shopping or are too busy to do so.

The last two categories have moderate risk, but product and market research can reduce it. They also offer opportunities for utilizing effective start-up strategies – innovation, differentiation, and market specification.

## **7. Entry Strategies for New Ventures**

It is easy to be captivated by the promise of entrepreneurship and the lure of becoming one's own boss. It can be difficult, however, for a prospective entrepreneur to determine what product or service to provide. Many factors need to be considered, including: an idea's market potential, the competition, financial resources, and one's skills and interests. Then it is important to ask: Why would a consumer choose to buy goods or services from this new firm?

One important factor is the uniqueness of the idea. By making a venture stand out from its competitors, uniqueness can help facilitate the entry of a new product or service into the market.

It is best to avoid an entry strategy based on low cost alone. New ventures tend to be small. Large firms usually have the advantage of lowering costs by producing large quantities.

Successful entrepreneurs often distinguish their ventures through differentiation, niche specification, and innovation.

- Differentiation is an attempt to separate the new company's product or service from that of its competitors. When differentiation is successful, the new product or service is relatively less sensitive to price fluctuations because customers value the quality that makes the product unique.

A product can be functionally similar to its competitors' product but have features that improve its operation, for example. It may be smaller, lighter, easier to use or install, etc. In 1982, Compaq Computer began competing with Apple and IBM. Its first product was a single-unit personal computer with a handle. The concept of a portable computer was new and extremely successful.

- Niche specification is an attempt to provide a product or service that fulfills the needs of a specific subset of consumers. By focusing on a fairly narrow market sector, a new venture may satisfy customer needs better than larger competitors can.

Changes in population characteristics may create opportunities to serve niche markets. One growing market segment in developed countries comprises people over 65 years old. Other niches include groups defined by interests or lifestyle, such as fitness enthusiasts, adventure-travel buffs, and working parents. In fact, some entrepreneurs specialize in making "homemade" dinners for working parents to heat and serve.

- Innovation is perhaps the defining characteristic of entrepreneurship. Visionary business expert Peter F. Drucker explained innovation as "change that creates a new dimension of performance." There are two main types of product innovation. Pioneering or radical innovation embodies a technological breakthrough or new-to-the-world product. Incremental innovations are modifications of existing products.

But innovation occurs in all aspects of businesses, from manufacturing processes to pricing policy. Tom Monaghan's decision in the late 1960s to create Domino's Pizza based on home delivery and Jeff Bezos's decision in 1995 to launch Amazon.com as a totally online bookstore are examples of innovative distribution strategies that revolutionized the marketplace.

Entrepreneurs in less-developed countries often innovate by imitating and adapting products created in developed countries. Drucker called this process "creative imitation." Creative imitation takes place whenever the imitators understand how an innovation can be applied, used, or sold in their particular market better than the original creators do.

Innovation, differentiation, and/or market specification are effective strategies to help a new venture to attract customers and start making sales.

## **8. Marketing Is Selling**

**M**arketing is often defined as all the activities involved in the transfer of goods from the producer to the consumer, including advertising, shipping, storing, and selling. For a new business, however, marketing means selling. Without paying customers to buy the goods or services, all the entrepreneur's plans and strategies will undoubtedly fail.

How does a new business get orders? Before launching the business, the entrepreneur should research the target market and analyze competitive products. "Most business sectors have specific marketing strategies that work best for them and have already been put into practice," entrepreneur Phil Holland said. In 1970, Holland founded Yum Yum Donut Shops, Inc., which grew into the largest chain of privately owned doughnut shops in the United States. He suggests analyzing competitors' successful selling methods, pricing, and advertising.

For example, an entrepreneur can also develop a file of potential customers by collecting names or mailing lists from local churches, schools, and community groups or other organizations. This file can be used later for direct mailings – even for invitations to the opening of the new business.

After the new firm is launched, its owners need to get information about their product or service to as many potential customers as possible – efficiently, effectively, and within the constraints of a budget.

The most effective salesperson in a new venture is often the head of the business. People will almost always take a call from the "president" of a firm. This is the person with the vision, the one who knows the advantages of the new venture, and who can make quick decisions. Many famous entrepreneurs, such as Bill Gates at Microsoft, have been gifted at selling their products.

Company-employed sales people can be effective for a new venture, particularly one aimed at a fairly narrow market. Direct sales conducted by mail order or on the Internet are less expensive options that can be equally successful.

External channels also can be used. Intermediaries, such as agents or distributors, can be hired to market a product or service. Such individuals must be treated fairly and paid promptly. Some analysts advise treating external representatives like insiders and offering them generous bonuses so that the product or service stands out among the many they represent.

Advertising and promotion are essential marketing tools. Newspaper, magazine, television, and radio advertisements are effective for reaching large numbers of consumers. A less expensive option is printing fliers, which can be mailed to potential customers, handed out door to door, or displayed in businesses that permit it. New companies can also compose new product releases, which trade magazines usually publish without charge.

It is important to be listed in local telephone directories that group similar businesses under a single heading, such as the Yellow Pages in the United States. It is also useful to be listed on Internet search engines such as Google or Yahoo, which are used by consumers for locating local businesses. These often link to a company's Web site, thereby communicating more information.

Publicity is also an extremely valuable way to promote a new product or service. New firms should send press releases to media outlets. A local newspaper might publish a feature about the startup. A TV or radio station might interview its owners. This can be very effective in generating sales, and it's free!