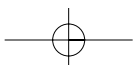
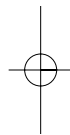
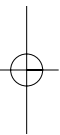


# PART I

## **Entrepreneurial Strategies for the Emerging Venture**



## CHAPTER 1

# Entrepreneurship and Strategy

### *A Framework for New Venture Development*

*A lot of people have ideas, but there are few who decide to do something about them now. Not tomorrow. Not next week. But today. The true entrepreneur is a doer, not a dreamer.*

—Nolan Bushnell, founder  
of Atari and Chuck E. Cheese's

#### Objectives:

1. Understand the key role of strategy in the discovery and exploitation of opportunities as entrepreneurial firms form and grow
2. Learn about contemporary trends and patterns in entrepreneurship, including its role in the global economy and the increase in social entrepreneurship
3. Understand the significance of entrepreneurial firms to innovation in the economy
4. Become aware of the key traits and behaviors associated with successful entrepreneurship
5. Learn how a well-established model of strategy (7S model) can be used to develop strategy for emerging organizations
6. Use the Creative Tool: Diagnostics for Entrepreneurial Systems to learn about needs, problems, and changes for an industry in which you are interested

## WANTED: Entrepreneur

**Immediate opening. Exciting, exhausting, high-risk position.**

Must have the ability to discover new business opportunities, discern market needs, and match with appropriate solutions before they become obvious. Applicant must be willing to invest hard work and create effort before others recognize the merit of their ideas. Ability to work with financial institutions, investors, and venture capitalists to attract financial backing will be essential for upward mobility in the position. Pay will be very poor for failure and very good for success.

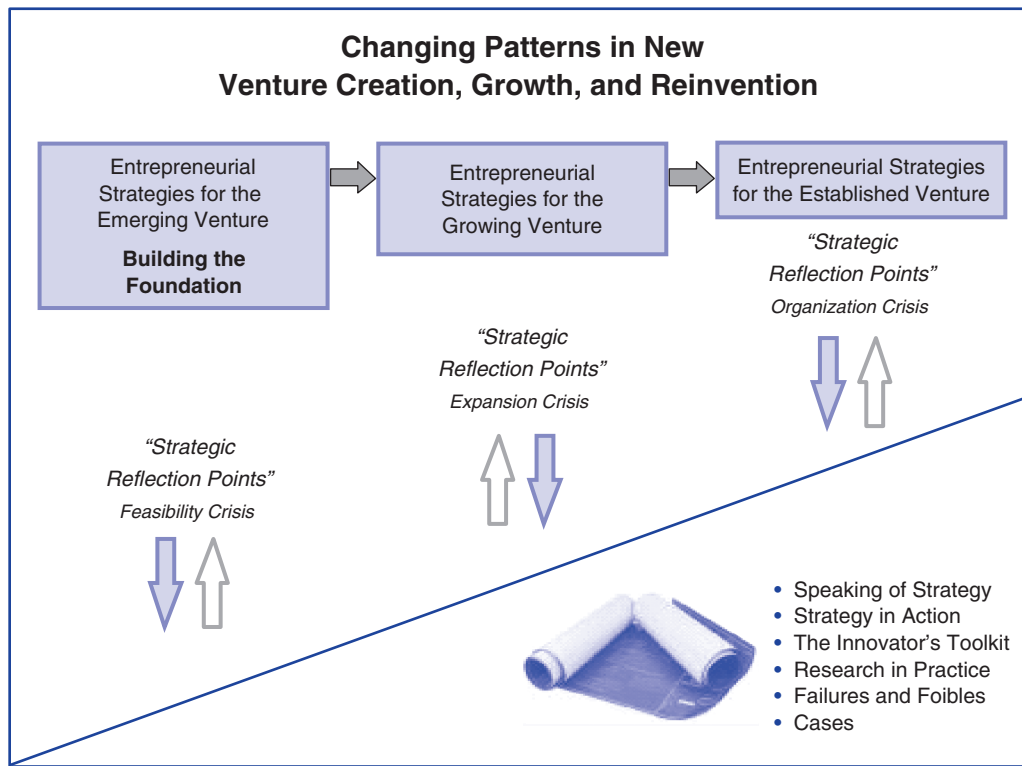
SOURCE: Russell S. Sobel, West Virginia University Entrepreneurship Center. Used with permission.

As you begin your entrepreneurship experience, you are embarking on a journey that is undertaken daily by millions of people around the world. Each step of this journey is one that involves the discovery, evaluation, and exploitation of opportunities to bring new goods, services, and processes to the marketplace (Shane, 2003; Venkataraman, 1997). Entrepreneurship can be defined as *the identification and exploitation of previously unexploited opportunities* (Hitt, Ireland, Camp, & Sexton, 2001). As you can see, the recognition of opportunities that lead to the creation of new business ventures is the heart of entrepreneurship today. Throughout this book, the following questions will guide our examination of the entrepreneurship process (Shane & Venkataraman, 2000, p. 18):

1. Why, when, and how do opportunities for the creation of goods and services come into existence?
2. Why, when, and how do some people and not others discover and exploit these opportunities?
3. Why, when, and how are different modes of strategic action used to exploit entrepreneurial opportunities?

What is the relationship between entrepreneurship and strategy? Both entrepreneurship and strategic management focus on the ways in which businesses create change by exploiting opportunities they discover within the uncertain environments in which they operate (Ireland, Hitt, & Sirmon, 2003). Entrepreneurs are able to create wealth by identifying opportunities and then developing competitive advantages to exploit them (Hitt & Ireland, 2002; Hitt et al., 2001; Ireland, Hitt, Camp, & Sexton, 2001). Thus, *strategic entrepreneurship* is the integration of entrepreneurship and strategic management knowledge (Ireland et al., 2003). Successful entrepreneurs are able to notice the possibilities that many other people seem to miss, and, more important, they are then able to find the means to turn these possibilities into action: to bring to the market something novel and useful.

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**Figure 1.1** Framework for the Book

This textbook presents a framework for strategy in entrepreneurial organizations that incorporates new venture emergence, early growth, and reinvention and innovation in established ventures. The focus of the text is on *entrepreneurial* strategies that can be crafted and implemented within small and medium-size organizations as these firms proceed through the stages of development. The unique approach of this book is its segmentation of entrepreneurship strategies *across the life cycle* of business growth. Most strategy texts present content that is segmented by the type or level of strategy (e.g., marketing, human resources, production strategies) rather than the changing pattern of strategic needs faced by the new venture. Finally, the textbook includes opportunities to examine and assess multiple themes and crisis points (labeled Strategic Reflection Points) that can determine the sustainability and growth of the emerging enterprise (see Figure 1.1).

Our book is written from the point of view of the founder or the entrepreneurial team. Increasingly, entrepreneurs are relying on the expertise and input of key stakeholders as they launch and develop their businesses. Whether these stakeholders are outside the firm in the role of advisers or inside in the roles of investors and employees, the entrepreneur’s ability to create a powerful team capable of breakthrough thinking shapes the new venture’s potential success and growth. This book strongly emphasizes the key strategic roles of *creativity*, *opportunity identification*, *opportunity evaluation and implementation*, and *continual innovation* in the emergence and growth of entrepreneurial firms. Table 1.1 displays these strategic roles,

**Table 1.1** Entrepreneurial Stages: Changing Patterns, Strategies, and Entrepreneurial Roles

|   | <i>Stage I: Entrepreneurial Strategies for the Emerging Venture</i>  | <i>Stage II: Entrepreneurial Strategies for the Growing Venture</i>   | <i>Stage III: Entrepreneurial Strategies for the Established Venture</i>   |
|---|--|---|--|
| Changing patterns of strategic needs of entrepreneurial firms | Strategic framework for new venture formation<br>Creativity and opportunity identification (the discovery process)<br>Evaluating and exploiting opportunities (the assessment process)<br>Market entry | Financial resource capabilities<br>The evolving management team: capabilities for nurturing growth by building networks and strategic alliances | Creativity and innovation strategies for breakthrough thinking: reinvention and change to sustain growth<br>Tapping new markets and opportunities: franchising, mergers & acquisitions |
|   | The strategic plan: vision and values, the internal and external environment, and organizational strategies for the entrepreneurial team   | The strategic plan for the growing venture  | Building an entrepreneurial model: Learning from failure and serial entrepreneurship   |
| Strategic roles   | Creativity, opportunity identification, and evaluation   | Opportunity implementation and firm growth  | Continual innovation and reinvention   |

along with the changing patterns and needs of the entrepreneurial firm and the overall strategy and planning initiatives needed to take the firm to the next stage of growth.

## Contemporary Entrepreneurship: Trends and Patterns

Emerging businesses are significant players in the world's economy today. In the United States, they produce about half of the economy's output, employ half of the private-sector workforce, fill niche markets, innovate, increase competition, and give people in all circumstances a chance to succeed. Across industries, new ventures are confronted by a variety of business conditions, and they tackle them with unique solutions using diverse resources (Small Business Office of Advocacy, 2004).

Entrepreneurial firms can be found in all sizes and in all stages of the life cycle. Over the last decade, small firms have provided 60 to 80 percent of the net new jobs in the economy, and according to the U.S. Bureau of the Census, most of these net new jobs come from start-ups within the first two years of operation (Acs & Armington, 2003). Most of the new employment in the economy continues to be an outgrowth of innovation, the engine that spurs job growth. Schumpeter (1942), one of the first economic scholars to focus on entrepreneurial activities, coined the

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term *creative destruction* to describe the phenomenon in which new firms innovate to enter the market and compete with already established businesses, and as a result, some of these older counterparts close due to lower productivity, which has put them at a competitive disadvantage.

Consider the following trends and patterns in recent entrepreneurial activity in the United States (Small Business Office of Advocacy, 2005):

- In 2004, there were about 5.8 million employer firms (nonfarm). From 1995–2003, self-employment increased by 8.2 percent, to a total of 15 million self-employed people. Women represented half of this increase; their share of self-employment was up from 33.1 percent to 34.2 percent.
- Following population trends, self-employment among individuals of Hispanic and Asian/Native American heritage has significantly increased between 1995 and 2003, 65.8 percent and 38.4 percent, respectively. African American self-employment also rose by 20.3 percent during this period.
- In 2004, small business fared well. The number of new employers exceeded those closing their businesses, and the number of self-employed increased.
- Entrepreneurial firms benefited from the continued recovery in the economy in 2004, along with the abundant supply of credit. Small business borrowing increased slightly. Equity investment for later-stage financing was easier to attract than early-stage financing. However, angel investors continued to be important for providing funding to early-stage entrepreneurs in 2004.
- In fiscal year 2004, the federal government granted \$69.2 billion, or 23 percent of \$299.9 billion in federal prime contracts to small businesses.

Around the world, entrepreneurial activity is thriving. The following findings emerged in the *Global Entrepreneurship Monitor's* research analysis of 34 countries (Acs, Arenius, Hay, & Minniti, 2005).

- A large number of people are engaged in entrepreneurial endeavors around the globe. About 73 million adults are either starting a new business or managing a young business of which they are also an owner. The average level of activity was 9.3 percent, representing 1 out of every 11 adults around the world.
- Three out of every five people involved in entrepreneurship around the world are opportunity entrepreneurs, defined as participating in entrepreneurial activities to exploit a perceived business opportunity. Opportunity entrepreneurs are more likely to be found in high-income countries.
- Two in five people are necessity entrepreneurs, who pursue entrepreneurship because all other employment options are either absent or unsatisfactory. Necessity entrepreneurs are more likely to be found in low-income countries.
- Young people between the ages of 25 and 34 tend to be involved in entrepreneurial activity in every country studied, more than people of any other age groups. This tended to vary by income levels, and low-income countries saw more activity across all age groups.
- In high-income countries, 57 percent of entrepreneurs have a postsecondary degree, compared to 38 percent in middle-income countries and 23 percent in low-income countries.

In summary, these patterns suggest very strongly that entrepreneurship is alive and vibrant around the globe. Economists agree that entrepreneurship is responsible for much of the competition and innovation in the business world. The innovations introduced by entrepreneurs challenge and make obsolete the technologies, products, and services of existing industries (Acs et al., 2005).

Innovation as the primary driver of entrepreneurial behavior is the focus of this book. One type of innovation that is gaining much attention today is social innovation, a mission of some entrepreneurs who are seeking not only to create new value in the form of products but also to create change in the very communities in which they reside.

## Entrepreneurship That Matters: Social Value Creation

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The literature widely assumes economic motives as the sole, or primary, purpose of new organization creation (Kirzner, 1983; Schumpeter, 1934). These themes pervade current literature, which sees the entrepreneurial process as one based on recognizing the value of resources and “exploiting” them for economic success (Shane & Venkataraman, 2000). “Entrepreneurship can be explained by considering the nexus of enterprising individuals and valuable opportunities” (Shane, 2003, p. 9)

At the same time, some evidence suggests that economic gain may not be the only, or key, motive for all entrepreneurs. For example, a review of literature (Newbert, 2003) found that economic motives such as wealth creation were generally not the prominent motive of entrepreneurs, who appear to have both economic and ethical motivations for their actions. Moreover, Wiklund, Davidsson, and Delmar (2003) suggest that “noneconomic” concerns may be more important than anticipated financial gain to small business managers when they consider expanding their firms. Specifically, concern about employee well-being was seen to be important; it may be viewed as a motivation for the “positive atmosphere” of the small venture. However, on a broader scale, consider the following remarks by UN Secretary-General Kofi Annan (1999):

Let us choose to unite the power of markets with the strength of universal ideals.  
Let us choose to reconcile the creative forces of private entrepreneurship with the needs of the disadvantaged and the requirements of future generations.

Why does recognizing the full picture matter when it comes to entrepreneurial motives? Secretary-General Annan’s rallying cry seems immensely timely. In recent times, corporate scandal has eroded trust and belief in the value of business and in its ability to create both economic *and* social progress. At the same time, significant inequalities and challenges exist in both developed and developing nations. Mr. Annan hopes that private enterprise that concerns itself with *both* economic and social value creation can be a powerful solution to world issues.

This idea of social value creation is rooted within the social entrepreneurship literature and has more recently received attention among academic and clinical entrepreneurship researchers. Underlying social entrepreneurship are the multiple

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benefits and rewards that are exhibited by a heightened sense of accountability to the constituencies served, as well as the outcomes that are created. Social entrepreneurs seek to provide social improvements and enhancements to their communities, including attractive (both social and financial) return to their key stakeholders. Social entrepreneurs assess their impact and influence in terms of the social outcomes, not simply in terms of size, growth, or processes. However, much of the social entrepreneurship field is concerned with the creation of nonprofit ventures. Although the creation of new and innovative nonprofits is critical, there is also a substantial need for educating future entrepreneurs about how for-profit venture creation can integrate both social and financial outcomes. A critical starting point is to understand the diverse “for whom and for what” motives and beliefs of our future aspiring entrepreneurs, so that both women and men act as the change agents for themselves and their communities, thereby allowing them to invent new profitable and sustainable approaches that create solutions to change society for the better.

### Strategy in Action

#### Social Entrepreneurs—Doing Business With a Conscience

There are many breeds of entrepreneurs. Some are out to revolutionize the software industry, some to start a family restaurant, while another might set out to provide employment in poverty-stricken areas or to bring medicine to the sick. It's still a business, but with different objectives. It is not to say that other entrepreneurs don't have a social conscience, but some make a career out of it. For them, the motivation is the drive to create social change. They see problems around them that they feel need to be addressed, yet aren't. They see kids with insufficient education, parents without jobs or the opportunity of employment, or sick countrymen without access to the proper health care.

Pushpika Freitas is a good example. A native of India and based in Chicago, IL, Freitas is a graduate of DePaul University. She was one of the founders of Marketplace India, a non-profit organization that employs Indian women in the poorer neighborhoods of Mumbai as artisans, designing and creating clothing lines that are sold in India and the United States.

“The primary goal is empowering the women through employment,” said Freitas. “If women cannot put food on the table, you cannot talk about dignity, you cannot talk about them making changes in their lives and the lives of their families.”

Marketplace India is currently extending its reach. It has been vital to the livelihoods of the nearly 500 women that the organization employs as artisans, and for many, this work constitutes one of the few, if any, options that these women have for employment. Religions, cultural and economic constraints play their role. Yet families have the same goals for their children as they do in the U.S. “It's not young women who just finished school who would be working with Marketplace, it's their mothers who would be,” says Freitas.

With Marketplace they have that opportunity, and with it comes larger implications. “That is the next step, bringing about social change,” said Freitas, “But having it come from grassroots as opposed to a middle-class Indian social worker coming in and saying, “this is what I think things should be.”



Freitas, who benefited from a good education and a progressive idealism instilled in her by her parents, was moved by the plight of a small group of Indian women she began working with over 20 years ago.

“Marketplace originated because it was very close to my heart . . . I got involved working with a couple of women and realized that they had very little control over their lives or over the money that they earned. It was at that point that I realized that I’m in the minority here, which is why I started Marketplace.”

Since then, the organization has grown to employ 480 artisans mostly in and around Mumbai. Much of the focus now is on getting more people involved in Marketplace.

“We want to expand the program,” said Freitas, “So at the moment we’re talking about 480 artisans, but tomorrow can we be at 1,000, can we be at 1,500?”

Social entrepreneurship has been given consistently more attention in recent years. It has had a long history in Chicago. Jane Addams formed the Hull House Settlement in Chicago with friend Ellen g. Starr in 1889, after visiting a similar settlement in Toynbee Hall, in London’s East End. She was moved and intrigued by poverty and its roots, one of the many causes she took up in her lifetime. Hull House was situated in the middle of one of the poorest neighborhoods in Chicago at the time (on the near west side) and was intended to be a place of education, culture and a safe haven for the area residents. She was not running a charity or overseeing a highly profitable corporation. The mission of Hull House was to empower the residents, to improve conditions, to give people help in the pulling themselves up by their bootstraps, who might not otherwise be allowed the opportunity.

Addams said, “Social advance depends as much upon the process through which it is secured as upon the result itself.” Her Hull House, which was host to around 2,000 people a week just a few years after its inception, helped countless immigrant families and neighborhood residents in her lifetime and beyond. In 1931, Jane Addams became the first American woman to be awarded the Nobel Peace Prize.

Others throughout history who have had a substantial impact through their social work can also be considered social entrepreneurs. Clara Barton, creator of the American Red Cross, James Grant, who helped to temporarily stop a war in El Salvador so the nation’s children could be immunized, and Bill Drayton—who also coined the term “social entrepreneur” over twenty years ago, who founded Ashoka, an organization that invests in social entrepreneurs throughout the world.

Social entrepreneurship is a relatively new name, but the idea has been around for many years. From Jane Addams to Pushpika Freitas, the driving force is the same: to empower people to better lives by providing them with the means to get that life, whether it be education, employment or even simple entertainment. They go into these new ventures with a mission not based on profits, but on social change. But at the same time, these organizations can be successful, self-sustaining businesses.

“I think that one of the things that Marketplace has demonstrated is that you can have a social goal and be involved in an economic venture,” notes Pushpika Freitas. “And I think more of this can be done.”

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SOURCE: Reprinted from *Epicentre*, Newsletter of the Coleman Entrepreneurship Center at DePaul University, Winter, 2005. Used with permission.

## Strategic Reflection Point

### Exploring a Social Entrepreneurship Mission

Find an organization that you believe has a social entrepreneurship mission (explore a couple of the social entrepreneurship Web sites including: [www.changemakers.net](http://www.changemakers.net) or [www.ashoka.org](http://www.ashoka.org)).

1. What do you see as being entrepreneurial (and not entrepreneurial)?
2. What is the relationship between the organization's mission and its actual activities and planned initiatives?
3. Do you have any suggestions about how the organization could improve its social entrepreneurship mission, strategy, and messaging to the community?

## The Role of Innovation in Entrepreneurship Strategy

One of this book's distinctive features is the emphasis on the role of innovation in the entrepreneurship start-up and growth process. Entrepreneurial firms are vital to the development of new ideas, technologies, and actions across industries today. While small entrepreneurial companies are not as common in capital-intensive industries such as auto manufacturing, aerospace, and oil research, they play major roles in the development of newer technology industries, including biotechnology, medical electronics, medical equipment, and telecommunications. Large companies are often dependent on small firms' discoveries and inventions (Small Business Office of Advocacy, 2004).

### Research in Practice: Small Firms and Innovation

Consider the following findings that are derived from research using a database of 1,270 innovative companies, conducted by the Small Business Administration's Office of Advocacy (2004).

- Between 2000 and 2002, the number of actively innovative firms (defined as firms with more than 15 patents during the previous five years) increased. Whereas 104 firms were dropped from the database, 318 firms were added to it.
- Small firms are having a powerful influence on technology. They represented 40 percent of the highly innovative firms in 2002, up from 33 percent in 2000.
- Large firms in biotechnology, medical electronics, semiconductor, and telecommunications industries have a higher than anticipated number of citations of small firm patents.

In conclusion, small firms are integral to the innovation process, even when they are not responsible for the final or breakthrough technology.

Throughout this book, students of entrepreneurship will find creative tools you can use to develop and implement strategies for the emergence, growth, and renewal of the entrepreneurial organization. Here is the first.

### The Innovator's Toolkit: Are You Right for Entrepreneurship?

Allis (2003) has developed a set of commonly noted traits of entrepreneurs. Being an entrepreneur is not for everyone. Not everyone can handle the risks and responsibilities of having dozens or hundreds of people's lives depending on your choices or the stress of reporting to a board of directors or panel of investors. An analysis of the traits commonly found among successful entrepreneurs may assist in deciding if you are right to be an entrepreneur.

Here is a list of commonly noted traits of entrepreneurs. Put a check next to each one you believe you have:

- |  |   |
|--|---|
| <input type="checkbox"/> Initiative                                      | <input type="checkbox"/> Ability to prioritize              |
| <input type="checkbox"/> Bias toward action                              | <input type="checkbox"/> Drive toward efficiency            |
| <input type="checkbox"/> Vision  | <input type="checkbox"/> Ability to take feedback           |
| <input type="checkbox"/> Determination                                   | <input type="checkbox"/> Tolerance for stress               |
| <input type="checkbox"/> Courage   | <input type="checkbox"/> Decisiveness                       |
| <input type="checkbox"/> Creativity                                      | <input type="checkbox"/> Ability to deal with failure       |
| <input type="checkbox"/> Perseverance and persistence                    | <input type="checkbox"/> Ability to learn from mistakes     |
| <input type="checkbox"/> Drive to achieve                                | <input type="checkbox"/> Ability to delay gratification     |
| <input type="checkbox"/> Orientation toward opportunity                  | <input type="checkbox"/> Ability to plan                    |
| <input type="checkbox"/> Ability to deal with the abstract and ambiguity | <input type="checkbox"/> Ability to build a team            |
|  | <input type="checkbox"/> Ability to inspire and lead people |

Do you have these attributes? If you checked more than half, you may have what it takes to become a successful entrepreneur.

As part of a series of interviews conducted with six successful entrepreneurs in the North Carolina region, Allis (2003) asked the question, What traits are most important for an aspiring entrepreneur to have? He gave the entrepreneurs 15 options and asked them to number their choices 1 through 15 in order of importance. The results were very interesting. The most important trait for aspiring entrepreneurs to have, according to these successful entrepreneurs, was "being able to build a solid team." The second and third most important skills were "leadership & the ability to inspire" and "persistence." The least important attribute of all, No. 15, was "a college degree." Here are the full results in order of importance:

- |  |                                       |
|--|---------------------------------------|
| 1. Being able to build a solid team    | 5. Integrity                          |
| 2. Leadership & the ability to inspire | 6. Ability to communicate effectively |
| 3. Persistence                         | 7. Confidence                         |
| 4. Motivation & ambition               | 8. Being able to execute              |

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- |                                |                                       |
|--------------------------------|---------------------------------------|
| 9. Having a bias toward action | 13. Having the right advisers         |
| 10. Having a good idea or plan | 14. Knowledge of accounting & finance |
| 11. Knowledge of marketing     | 15. A college degree                  |
| 12. Good networking skills     |                                       |

Would you work 70- hour plus weeks for months on end, sleep at the office when you get backed up, and put your own money on the line when payroll is due and the bank has yet to approve a loan? Would you be the janitor, the receptionist, the custom support representative, and the bookkeeper, as well as the president? Could you get up and present in front of a room of investors, after already being turned down by 105 other banks, angel investors, and venture capital firms? If you think so, then you just might have what it takes to become a successful entrepreneur.

SOURCE: From Allis, R., *Zero to One Million*. Virante, Inc., www.zeromillion.com, copyright © 2003. Reprinted with permission.

No successful entrepreneur would say it is easy or that no risk is involved. If it were easy, if there was no risk, and if it did not take years of dedication and persistence, everyone might be an entrepreneur. Unfortunately, the market does not have compassion or feelings. It doesn't pull for the person who works the hardest or has the best idea. It pulls for the person who works the most intelligently, sells what the market demands, puts together the needed resources, and executes. Let's take a look at the best and worst things about being an entrepreneur.

### Failures and Foibles

#### The Next Time I Start a New Venture . . .

Although many entrepreneurs make their share of mistakes, the seasoned entrepreneur is able to turn those mistakes into ideas and plans of what NOT to do the second, third time around. Consider the following statements from entrepreneurs who comment on the next time they start a new venture:

- I will make sure I have sufficient start-up and back-up capital. Nothing is as sure to kill a new venture as running out of money early in the game. If your plan says you need a certain amount of capital, get it—and a little more, for back-up.
- I will be certain there is a market for my “great idea” before I run with it. I'll never be caught with a “solution in search of a problem” again!
- I will spend more time and care managing the business. I don't like to deal with details, but somebody has to or the business will suffer. Next time I'll hire a manager to do right what I was doing ineffectively.
- I'll know something about the business I plan to start. Nothing is as sure a sign of impending trouble than an entrepreneur who asks, “how hard can it be?” when he or she has

never before done whatever “it” is. I’ll stick to a business I know, or I’ll make darn sure I learn about it before I start.

- I’ll have “It’s the cash flow, Stupid!” tattooed on my forehead. Cash-flow problems are easy to understand. If your suppliers give you 30 days to pay, and you give your customers 60 days to pay, the cash will flow out before it can flow in. Duh.
- I will have a lawyer draw up my partnership agreements. I will not let my partners become “former friends.”
- I will know my competition as well as or better than my competition knows me, and I will look for competitors where I least expect to find them.
- I will stay on top of new developments. I will never stop learning about my business and my customers.
- I will plan for success and growth. Too much success is a bad thing if you’re not prepared for it.
- I will maintain a balance in my life between work and family. I will not let my success go to my head.
- I will learn how to count up to ten. I will not try to make two and two equal five, just because I’m so sure things will turn out better than I have any good reason to expect they will.

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SOURCE: List from Canadian Foundation for Economic Education. [www.cfee.org](http://www.cfee.org). Reprinted with permission.

## Review Questions

1. How do you think most entrepreneurs view failure? (Consider the implicit assumptions and weigh the positive and negative consequences of failure.)
2. How much do you think the severity of the failure matters in influencing the entrepreneur to launch another business?
3. How do other countries view failure and its association with entrepreneurial start-up (e.g., choose Germany, Sweden, China, Brazil)? Does it hinder the rate of start-up activity in that country?

## Beyond Traits: Scripting Our Own Entrepreneurial Strategies

Entrepreneurs may not differ significantly in personality, and they may agree on the most common mistakes they have made over their entrepreneurial career; however, they may perceive and act upon new opportunities in different ways. These differences may be due to how they think and process information they receive on a daily basis. Researchers have commented that one way to increase an individual’s effectiveness in the new venture creation process is to better understand the role of entrepreneurial cognition. As defined by Mitchell et al. (2002), “entrepreneurial

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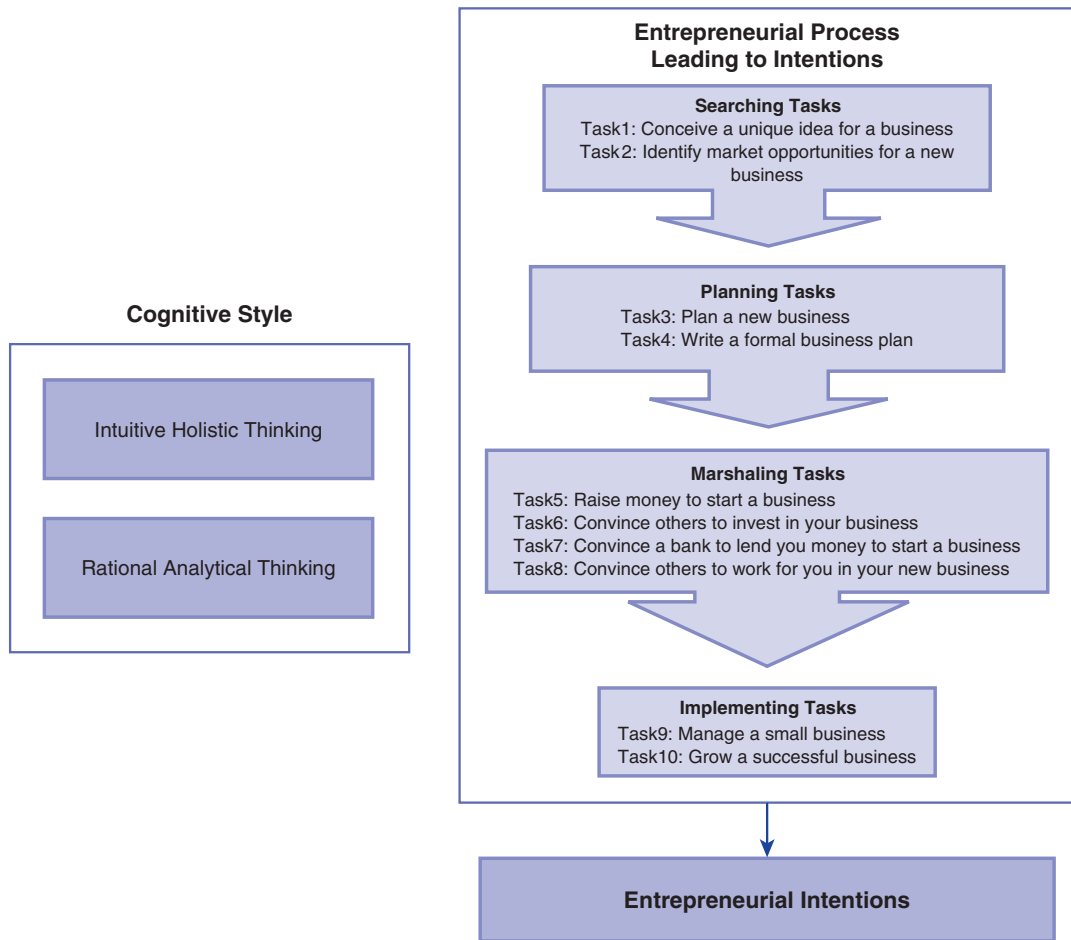
cognitions are the knowledge structures that people use to make assessments, judgments, or decisions involving opportunity evaluation, venture creation, and growth” (p. 97). Researchers have postulated that cognition has the potential to make a significant contribution to the study of entrepreneurship (e.g., Allinson, Chell, & Hayes, 2000; Allinson & Hayes, 1996; Baron, 1998; Busenitz & Barney, 1997; Mitchell et al., 2002) and that understanding entrepreneurial cognition is imperative to comprehend what creates the notion of “entrepreneurial alertness” (Kirzner, 1979) and how it can be developed to encourage entrepreneurial behaviors and strategic action for the firm.

To better comprehend entrepreneurial cognition, researchers have developed a cognitive style model with multiple dimensions (e.g., Allinson & Hayes, 1996; Leonard, Scholl, & Kowalski, 1999). Early on, Ornstein (1977) referred to two modes of awareness, reflecting the rational and intuitive sides of an individual. Other scholars have noted that nearly all cognitive styles are “subordinate to, and reflect, a broad super-ordinate stylistic difference” (Miller, 1987, p. 253), and this represents a long-established distinction between contrasting modes of thought (Sadler-Smith & Allinson, 2000). According to Nickerson, Perkins, and Smith (1985):

The view that there are two qualitatively different types of thinking is widely shared. Among the terms used to describe one type are analytic, deductive, rigorous, constrained, convergent, formal and critical. Representative of the terms used to describe the other type are synthetic, inductive, expansive, unconstrained, divergent, informal, diffuse and creative. No doubt the partitioning of thinking into two types involves something of an oversimplification but possibly a useful one. (p. 50)

This superordinate dimension of cognitive style is identified as intuition analysis (Allinson et al., 2000). Drawing on the work of a number of theorists and empirical researchers who have argued that the dimensions of cognitive style can be ordered within a unitary framework, Allinson and Hayes (1996) reported the development and validation of a new instrument, the Cognitive Style Index (CSI). Thus, an individual’s cognitive style may influence their preference for different types of learning, knowledge gathering, information processing, and decision making, which constitute many of the critical stages and related tasks an entrepreneur is confronted with in developing a business. Kickul, Gundry, and Whitcanack (in press) developed a model (see Figure 1.2) that describes several of the relevant tasks associated with the intention to launch a new venture and its initiation.

The Kickul et al. (in press) study reveals the influence of cognitive style on entrepreneurial self-efficacy and shows that styles can predict how students perceive their own self-efficacy regarding different stages of the entrepreneurial intentions model. The results disclosed that an individual’s cognitive style mattered greatly in directing attention to specific tasks of the new venture development process that fit most closely with his or her preferred style and away from other tasks that rely on the thinking style that is less preferred. For example, Kickul et al. found that individuals who prefer the intuitive style of information processing were comfortable with the opportunity identification task (e.g., discovery and refinement of new ideas and



**Figure 1.2** Entrepreneurial Process Leading to Intentions

opportunities) of the new venture development process and then wanted to proceed directly to implementing their ideas. The problem with this approach is that necessary stages of the venture development process are skipped entirely, or at best given very short shrift, in this group's rush to get to the implementation tasks. Similarly, individuals with the analytic preferred mode of thinking skip the search for opportunities and begin the venture development process with the planning tasks. Thus, they pay little attention to the need for divergent thinking to refine and improve an idea or opportunity, preferring to get right to the work of building the business.

These findings facilitate our understanding of why, for example, some entrepreneurs discover gaps in the plan or infrastructure of their new ventures that may have been the result of such cognitive "skipping over" the key tasks in the business creation process. Furthermore, the research may indicate the important role of pedagogical approaches and new methodologies in entrepreneurship education. The pedagogical goal is to effectively stimulate student development in both the

intuitive and analytic cognitive areas so that students are able to fully participate in all stages of the new venture creation cycle and deepen their entrepreneurial intentions. Many of the new methodologies and approaches to learning about entrepreneurship are within this textbook and in the following chapters in the form of cases, strategic reflection points, research in practice examples, and failures and foibles.

## Whole Brain Thinking: An Introduction to Strategy for the Emerging Venture Using the 7-S Model

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One of the initial steps in firm creation is the development of a strategic framework in which new opportunities and innovations can be quickly positioned within your venture. One such framework is the McKinsey 7-S Model (developed by Tom Peters and Robert Waterman, former consultants at McKinsey & Co). They described the 7-S Model in their article “Structure Is Not Organization” (Waterman, Peters, & Phillips, 1980) and *In Search of Excellence* (Peters & Waterman, 1982). The model is still relevant to venture development today.

The model builds on the premise that an organization consists of seven elements, divided into what the authors called the hard S’s and the soft S’s (Waterman et al., 1980). The hard S’s (Strategy, Structure, and Systems) are fairly easy to identify. They can be found in companies’ strategy statements, corporate plans, organizational charts, and other documentations.

The four soft S’s (Style, Staff, Skills, and Shared Values/Superordinate Goals), however, are more embedded in the organization and more challenging to locate. They are difficult to describe because capabilities, values, and dimensions of the company culture are continuously developing and changing. The soft S’s are highly determined by the people who work in the organization. Therefore, it is much more difficult to plan or to influence the characteristics of the soft elements. Although the soft factors are below the surface, they strongly influence the Structures, Strategies, and Systems of the organization. Table 1.2 presents the 7-S Model adapted from Waterman et al. (1980), applied to entrepreneurial firms.

Effective entrepreneurial organizations achieve a fit between these seven elements. If one element changes, it affects all the others. For example, integrating new technology into the business influences Staff and Skills, in that employees must learn new ways of doing things. In turn, their performance expectations are likely to change. The interaction with customers may also be different than it was at start-up.

As small firms grow and change in response to markets and other demands of their environment, many entrepreneurs focus their efforts on the hard S’s—Strategy, Structure and Systems—because these are much easier to observe and change. However, it is just as vital to the survival of the business that entrepreneurs pay attention to the soft S’s: Skills, Staff, Style, and Shared Values. We know from the landmark book, *In Search of Excellence* (Peters & Waterman, 1982), that most successful businesses work hard at and excel at these soft S’s. In fact, the soft factors can make or break a company because new structures and strategies are difficult to build if they rely on entrepreneurial styles and values that are a poor fit with the needs of a changing company. These problems often are visible in the dissatisfying



**Table 1.2** Description of the 7-S Model: Applications to Entrepreneurial Firms

| <i>The Hard S's</i>                   | <i>Description</i>   |
|---------------------------------------|--|
| Strategy                              | Actions a company plans to launch its venture and enter the marketplace, in response to or anticipation of changes in its external environment: the competitive advantage offered by the firm.   |
| Structure                             | Basis for specialization and coordination influenced primarily by strategy, firm size, and diversity. The configuration of tasks and individuals/teams required to achieve desired performance.  |
| Systems                               | Formal and informal processes and procedures that support the strategy and structure of the firm through launch and growth, enabling the firm to operate as a well-oiled machine.  |
| <i>The Soft S's</i>                   |  |
| Style / Culture                       | The culture of the organization, consisting of two components: <ul style="list-style-type: none"> <li>• Organizational Culture: the dominant values, beliefs, and norms that evolve over time and become relatively enduring features of organizational life. The founder and start-up team establish these values and reward desired performance, leading to shared expectations.</li> <li>• Management Style: The behavior of managers: what they expect and reinforce. What does the founder and management team focus on? What matters to them and how do they carry out the mission and values of the company?</li> </ul> |
| Staff                                 | The people in the company and the processes used to develop managers and employees. How are newcomers introduced to the company's way of doing things (socialization)? Career development opportunities in the company.  |
| Skills                                | The distinctive competences—what the company does best, ways of expanding or shifting competences as the firm moves from start-up to early growth, maturation, and reinvention.  |
| Shared Values/<br>Superordinate Goals | Guiding concepts: what is important to the founders. The principles guiding the business to meet its stated goals. As the firm grows, values and goals are shared and understood.  |

SOURCE: Adapted from R. H. Waterman, Jr., T. J. Peters, and J. R. Phillips, "Structure Is Not Organization," *Business Horizons* 23, no. 3(1980): 14–26.

results of spectacular mega-mergers. The lack of success and synergies in such mergers often results from a clash of completely different cultures, values, and styles, which makes it difficult to establish effective common systems and structures. Although many entrepreneurial firms are never involved in mega-mergers, it is never too early in the firm's life cycle to pay close attention to the soft S's and build the new organization in a mindful way.

## Strategic Reflection Point

### The 7-S's and Entrepreneurship

- Why do some entrepreneurs pay less attention to the so-called soft S's in the model above? In your experience, have you known entrepreneurs or managers who neglected these elements? Why is this a pitfall for new venture development and business growth?
- Do you think that in the present business climate, customers, employees, suppliers, and other stakeholders of a venture are increasingly aware of the importance of the Skills, Staff, Style, and Shared Values?
- How have ethical values and expectations changed with regard to entrepreneurial activities?

The 7-S Model is a valuable tool to initiate entrepreneurial change processes and to give them direction. A helpful application is to determine the current state of each element and to compare this with the ideal state. Based on your findings, you can develop action plans to achieve the intended state.

One of the many ways that you can make use of many of these elements to your advantage is to consider the following tool, which allows you to view how each element may relate to and intersect with others in building your own entrepreneurial organization.

### The Innovator's Toolkit:

### Diagnostics for Entrepreneurial Systems Throughout the Venture's Life Cycle

One of the first steps in developing an understanding of entrepreneurship is to begin the research process by interviewing entrepreneurs. This provides the would-be entrepreneur with much useful information that can be used to begin to diagnose whether an idea is workable and how to transform it into a new venture (adapted from French & Bell, 1978).

*Step 1:* In the space below list the five or six most important questions you would ask the entrepreneur about his or her organization:

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*Step 2:* In the following list, circle those variables that your five or six questions would address. Add any variables not listed that your questions would address.

- |   |  |
|---|--|
| 1. Formal authority structure                                     | 15. Satisfaction of members with interpersonal relationships     |
| 2. Work-process technology  | 16. Strategy and mission of organization                         |
| 3. Informal teams and groupings                                   | 17. Resource limitations   |
| 4. Relation of system to external factors: government and markets | 18. Communication and information channels                       |
| 5. Formal reward system   | 19. Informal leadership  |
| 6. Informal reward system   | 20. Control systems (including operating and accounting systems) |
| 7. Selection of employees   | 21. _____  |
| 8. Employee and management training and development               | 22. _____  |
| 9. Organizational culture: norms and values                       | 23. _____  |
| 10. Financial performance: equity, assets, profitability          | 24. _____  |
| 11. Employee and management turnover                              | 25. _____  |
| 12. Employee satisfaction with roles/positions                    | 26. _____  |
| 13. Employee performance evaluations                              | 27. _____  |
| 14. Performance evaluation and appraisal of organizational units  |  |

*Step 3:* Arrange the variables you have checked into categories. Look over the items you have checked to determine whether they fall into groupings. In the spaces provided here, list the items that belong together, describe their common theme, and give each grouping a descriptive name.

**Category name:**

*(Variables)*

Briefly describe why items fall in this group.

**Category name:**

*(Variables)*

Briefly describe why items fall in this group.

**Category name:**

*(Variables)*

Briefly describe why items fall in this group.

**Category name:**

*(Variables)*

Briefly describe why items fall in this group.

**Category name:**

*(Variables)*

Briefly describe why items fall in this group.

**Category name:**

*(Variables)*

Briefly describe why items fall in this group.

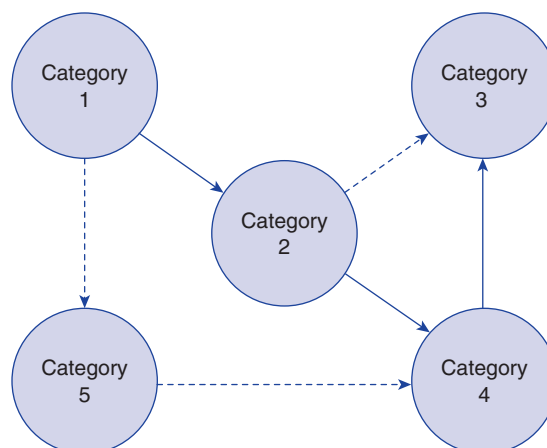
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*Step 4:* This next section is designed to help you understand the relationships among the categories you have just created. First, list each category in the appropriate space in the left-hand column of the following table. Then imagine that the elements of Category 1 underwent major change (which is quite likely within the life span of an organization). Assign each of the other categories (write in the category number) to one of the three spaces to the right of Category 1 to indicate what you feel would be the likely effects. Do the same for all the remaining categories you have listed (use category numbers below).

### Categorical Diagnostics

|            |  | <i>Likely to show<br/>a great deal<br/>of change</i> | <i>Likely to show<br/>moderate<br/>change</i> | <i>Likely to show<br/>no change</i> |
|------------|--|--|---|-------------------------------------|
| Category 1 |  |  |   |                                     |
| Category 2 |  |  |   |                                     |
| Category 3 |  |  |   |                                     |
| Category 4 |  |  |   |                                     |
| Category 5 |  |  |   |                                     |
| Category 6 |  |  |   |                                     |
| Category 7 |  |  |   |                                     |
| Category 8 |  |  |   |                                     |

You can now depict your own entrepreneurial organization graphically by drawing a picture of the causal relationships between the categories. For each category, draw a circle and write the name of the category in the circle. Then draw arrows between the various circles to represent the direction of influence between them. For example, if Category 1 is likely to cause change in Category 2, it might appear as follows:



If only moderate change is likely to occur, draw a dotted line between categories. Now arrange all the circles and arrows in a way that most clearly depicts the relationships. Which categories seem to have the strongest ties or relationships with others? Is one category more central or essential in influencing other categories? As your firm grows, consider which categories you have the most and least control over. As an entrepreneur, how can you mitigate and positively change the influence that one category has on another?

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## Summary of Chapter Objectives

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1. Understand the key role of strategy in the discovery and exploitation of opportunities as entrepreneurial firms form and grow.
  - This book strongly emphasizes the key strategic roles of creativity, opportunity identification, opportunity evaluation, and innovation in the emergence and growth of entrepreneurial firms.
  - This strategic approach examines three distinct stages of the entrepreneurship process, and provides you with strategies you can use to launch, grow, and revitalize the firm.
2. Learn about contemporary trends and patterns in entrepreneurship, including its role in the global economy and the increase in social entrepreneurship.
  - Entrepreneurships are formed by 1 out of every 11 adults around the world today. In the United States, entrepreneurships produce about half the economic output, employ half of the private sector workforce, and give people in all circumstances a chance to succeed.
  - The number and percentage of people of color and women who start companies are increasing significantly.
  - Entrepreneurships are continuing to benefit from the economic recovery. Credit is more abundant, and while equity investment is still difficult to attract for early-stage financing, angel investments are available.
  - Social entrepreneurs are driven to empower people by providing the means to better their lives; the mission of these self-sustaining firms is social change.
3. Understand the significance of entrepreneurial firms to innovation in the economy.
  - Entrepreneurial firms account for a significant percentage of patents and innovations.
  - Large firms rely on smaller firms, especially in newer technologies such as biotechnology, medical electronics, and telecommunications.
  - As you will see throughout this book, innovation can be a highly successful competitive strategy for the survival and growth of firms.

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4. Become aware of the key traits and behaviors associated with successful entrepreneurship
  - There are many traits and behaviors of successful entrepreneurs. Some of these can certainly be learned and reinforced to better prepare you for the journey to entrepreneurship.
  - Beyond traits and behavior, entrepreneurial cognition can have a significant influence on how you consider and evaluate the different tasks in the new venture creation process.
  
5. Learn how a well-established model of strategy (7-S Model) can be used to develop strategy for emerging organizations
  - These seven elements are distinguished in so-called hard S's and soft S's. The hard elements are simpler to identify. They are the Structures, Strategies, and Systems of the firm. They can be found in strategy statements, corporate plans, organizational charts, and other documentations.
  - The four soft S's, however, are difficult to describe because capabilities, values, and elements of corporate culture are continuously developing and changing. These elements are the Skills, Staff, Style, and Shared Values found in the organization. They are highly determined by the people who work in the organization. Therefore, it is much more difficult to plan or to influence the characteristics of the soft elements. Although the soft factors are below the surface, they can have a great impact of the hard Structures, Strategies, and Systems of the organization.
  
6. Use the creative tool, Diagnostics for Entrepreneurial Systems, to learn about needs, problems, and changes for a firm and industry in which you are interested.
  - Begin the information-gathering process by interviewing entrepreneurs in the industry in which you are interested.
  - The diagnostics tool will help you become attuned to the needed changes in the industry and market and help you become more idea prone.

## CASE 1.1 Floral Design Business in Full Bloom

Call it stubbornness, call it ingenuity, call it what you want; but entrepreneurs follow their own path. “I was the classic artisan entrepreneur,” said Casey Cooper, owner of Botanicals Inc., “I hated being told what to do and I was going to do my own flowers.” She did just that. Starting out doing flowers for a friend’s wedding ten years ago, arranging the flowers on her washing machine, she has built up Botanicals Inc. to be one of the most well-known and respected floral design businesses in Chicago.

Cooper, a DePaul University graduate, has been in the floral industry for nearly twenty years, working at various flower shops and freelancing with others. After graduating from DePaul, she went into theatre and helped to found a theatre company in Chicago, where she worked for two years as Artistic Director. But after doing the flowers for her friend’s wedding, one reference led to another and orders slowly started coming in. She decided to make a business out of it.

Her previous experience in the business was crucial in her own venture, especially in the floral industry, although running her own business proved to be a bit different. “It is a tough business because you’re dealing with perishable products which are expensive, and you’re dealing with expensive staffing, because you need people that are skilled,” said Cooper, “And you’re dealing with really subjective clients, because color and design is very subjective.”

Within a couple of years, the basement operation was outgrown and the business was moved to an old Wicker Park mansion. Not long after, more space was needed, so another move was made, followed by an expansion, and then a final move to the location that Botanicals is housed in now, a 6,500 square foot studio near Lincoln Park that has housed the business since 2002.

### Setting the Standard

During her years in the flower industry, Cooper developed a sense of how she wanted

her work to look like. “For a long time there was this very tortured-looking, high-style shlocky stuff out there that people do, and still do. We veered away from that,” said Cooper. “Everything we do is extremely organic, whether it is modern and [chic], it still has a very organic feeling and root to it. Our product quality is something that we protect beyond anything.”

With a vision in mind, she continued to expand the client base and ended up getting the attention of local magazines and media, which featured her business in several pieces. As time went on, Botanicals went from doing weddings to large-scale corporate and social events, even doing work for the Field Museum events, as well as being featured on Oprah’s 50th birthday show earlier in 2004. “To expand and push beyond our limits, I think is something we’ve become very well known for,” said Cooper. Not long ago the services offered by Botanicals were expanded as clients asked for more than flower arrangements. Botanicals Inc. now does complete designs for special events, including table settings, lighting, props, linens, and so on.

### Getting Better With Age

The rise in business that Botanicals has seen in the past couple years has not made Cooper’s job any more difficult. If anything, she seems more comfortable now than she did years ago, “The more growth we experience now, the better the infrastructure is really. It feels better, and it runs more smoothly,” said Cooper. “It’s been such a natural evolution that it doesn’t feel like there’s any additional pressure on.” It seems the most irritation she will face on any given day is a touchy smoke alarm, which goes off whenever someone uses the toaster in the break room.

She has got plenty of help with her, too. Since hiring the first full-time employee back in 1997, she has since grown the business to the point where it employs 35 people, full-time and part-time included. The new design studio on Elston

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Avenue is state of the art, with 6,500 square feet of space to accommodate the level of business they handle.

It has been over a decade since she started setting up flower arrangements on her washing machine, and yet time seems to fly by when it comes to the business. “It’s always been fast, and it still feels fast,” she said, “It feels like there’s this train that started and we’re always running behind it trying to get on.”

### A Look Back

Without a doubt, the experience she had working in the floral industry before going into business for herself was essential, but that experience was mostly limited to the creative, design-oriented part of the business. “Just because I was good at doing flowers didn’t mean that I was cut out to run this huge business,” she said. She did have a good sense of design and how to pick up new business along the way, but never really sought out consulting help until recently.

“I did not build this business to support the life that I wanted to have. I just kept building the business, and all of the sudden it was like, ‘This is not the life I want.’ So there was a lot of back-tracking and trying to figure out how we

can set this up to support the life we want,” she said. Cooper credits the business consulting she received with helping to sort some of that out.

Now, with things running smoothly, she is taking time to focus on some other aspects of her business. Starting in January, she will be teaching design classes, and she is also currently working on a book project. For the first time in quite a while, she is taking a step back, “This is probably the first time in 10 years that I feel like I can actually catch my breath.”

SOURCE: Reprinted from *Epicentre*, Newsletter of the Coleman Entrepreneurship Center at DePaul University, Winter, 2005. Used with permission.

### Discussion Questions

1. What were some of the key decisions Casey Cooper had to make as Botanicals, Inc. grew?
2. What entrepreneurial skills were needed as the business launched? Did these needs change over time?
3. What do you recommend Cooper do now? Are there opportunities she could pursue?



## CASE 1.2 Speaking of Strategy: Southport Grocery and Café

Southport Grocery and Café is a specialty food store and café located in the middle of the burgeoning shopping and dining destination that is the Southport Avenue corridor on the north side of Chicago, Illinois. The neighborhood is known as Lakeview, and Southport Grocery & Café captures the quality-focused, yet down-to-earth nature of its neighbors. This same balance occurs in the café’s kitchen, with dishes that are at once modern and new, yet accessible and comforting.

Owner/chef Lisa Santos has combined an exciting array of specialty food groceries and a charming café serving modern comfort food. Founded in 2003, Lisa Santos discovered a way to combine her love of food with her business acumen and experience. She describes her strategy as, “We’re a learning environment for food.” Eighteen months after its opening, Southport Grocery and Café has 4 full-time employees and 9 part-time employees. The story, however, starts much earlier.



## The Passion for Food Begins

Lisa Santos' passion for food began at an early age. "I still have my first cookbook from when I was 5 years old. Some of my fondest childhood memories are of sleepovers at my grandma's house where we'd just hang out in the kitchen and bake." After spending more than ten years in Financial Services at CNA Insurance Company, Lisa decided to follow her passion for food and enrolled in the Cooking & Hospitality Institute of Chicago (CHIC).

"From the very beginning, even before cooking school, I had thought of starting my own food business. When I travel, I love digging around in fine food groceries just as much as I like dining at new restaurants. Southport Grocery and Café is a great blend of both of these interests—interests that I think many Chicagoans share. I like doing things that aren't already done," says Lisa, "And this combination of fine food groceries and a café meets the needs of people who love to cook as well as those who just love to eat!" While many specialty grocers have an international focus, Southport Grocery & Café fills an unusual niche by first concentrating on domestic foodstuffs. "It's such an interesting time in American food production. It's very possible now to find high-quality specialty products and artisan-produced foodstuffs right here in the U.S." And Lisa admits that finding a passionate producer or artisan is almost as important as the product itself.

"I really enjoy the hunt of finding things that are good AND domestic. The best part of that search is finding a company where the owners are just as excited about being found as you are about [tasting] their product. That energy and momentum really carries through to our enthusiasm in the store." The café menu changes seasonally to reflect the best products available. The revenue split is approximately 35% grocery to 65% café, although in some months the split is even. Annual revenue in 2004 was \$450,000.00. The growth rate has been 11% in its first year. The grocery business tends to increase around the holidays. Lisa explains that at start-up,

"We had both the grocery and the café. But then we didn't know whether the concept was going to take off. Are people going to get these groceries? These are higher end, fine food groceries. And I'm happy to say although we've had to tweak some things we carry, people get it. And I think it's why people want to come to us—because it's a little different. It's not just a café and it's not just a fine food grocery. And we use a lot in our menu. We say right on our menu 'featuring the products of the grocery store' because we really try to cross-market the two sides of our store.

"When you open you go with a lot of 'gut'—you know what you think will work, you go by intuition, whatever. Over time you tweak it as you listen to the customer. It's amazing how valuable that is. But then, over time, you have information. A great example of how you've got to go with your gut sometimes, but you've also got to look at your information happened last January. I went to the Fancy Food Show—it's one of the big trade shows. Before we went, I knew what products I like, what I'm looking for, what packaging sells, that kind of thing. I thought I'd better get some information on what the top selling product groups in my store are. I just ran a report in ten seconds. My gut was *completely* wrong. I thought our best sellers were pastas, sauces—you know, easy to make dinner-type stuff. Those *are* good selling items. But it was by far candy. And it's not like candy was first and pastas and sauces were a close second—it was third!

"That tells me our customers are here to enjoy and treat themselves. Not too long ago, vendors were coming to us with low-carb bread, and we tasted it and thought, this is horrible! I'm not going to serve this. So we didn't do anything. So for a short period of time we had people doing things like ordering the burger without the bun, you know what I mean? But, now that's all over with, at least for our customers. So that was very eye-opening—to look at what moves, what doesn't move, and then marry what my gut says to the numbers.

"I concern myself with looking for high-quality, artisan product—we're talking grocery-side now. I also concern myself with learning

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about what specialty foods the large grocers are beginning to offer. I have it pretty easy with the big grocer near me, because they put these foods in little kiosks that kind of bump out on the aisle so I can preview what they're doing. And a lot of times it keeps me on my toes. It doesn't really bother me because I've got lots of products that are out there that don't go through the big distributors. It really keeps me focused on differentiating ourselves.

"There are two distinct markets in the grocery side of my business. There are the people that are big cooks, home chefs, and they're looking for a certain kind of oil or whatever and they come in looking for it. And then there are other people who like to cook, they like food, they like to do interesting things, they're having people over, but they're busy. They don't have time to figure it out. They just want something to serve their friends. And the other thing that's really starting to happen, the thing I see more and more, is people using the two sides of our business, because the store is not literally split. When you see the store from the street you can tell that there's a café and there's a grocery—it's not one behind the other. I wanted people to be able to see and react, 'Wow there's a lot going on in there. I want to go in there.' It's great to see people waiting for their food and they'll pop up and start looking at the groceries and they start stock-piling stuff, or they finish eating and they say, 'That vinaigrette you make for the fruit is really good. Do you sell it?' It's nice to see that people experience both sides of it.

"Also, my market is neighborhood and it is destination. When we first opened, I would have thought we would have been a neighborhood place. I mean we are, but there are a lot of people who hear about us and come from other areas. It's a lot bigger percentage than I thought when we first opened. And I think it's that differentiation. For the neighborhood people, there's nothing else like us on the street, even from a food perspective. There's a lot of bar food and a lot of things with the TVs on the walls and all that. And that gets to be kind of old. Especially

if you have kids you don't necessarily want to be eating all the time with the television on."

What is the competitive environment for Southport Grocery and Café? There is no direct competition in the area; there are places that sell prepared food to take out and have a couple of little tables for customers to sit down and eat, but nobody with an actual café. "Nobody has the specific model we have. And that's what I think is a little risky, because you don't know if it will work, but it differentiates us from everybody. I've noticed I get a lot of calls from realtors, building owners, who love the concept. They think their neighborhood needs one. It's quite a compliment. I'm just not ready yet, even from an investment standpoint. There are two ways to go with this business. One is to open more, but another is to take certain aspects of the business and get expertise at them. We wholesale out our baked goods now to five locations. I never dreamed that I would be wholesaling out our baked goods, but we bake our own things and people love them.

"Now is the time . . . I have a year-and-a-half of data, so I can really sit down and say OK, how much can the store really make? Where do I take it from here? Is it better to open another location? Is it better to take baking, move it somewhere else with cheap rent, and market everything out of wholesaling, and then maybe do that with our prepared food? To me, just from a personal perspective, that's a lot more interesting than just opening another location—I think it's the control problem I have because if there's more than one location, there's only one of me. And letting the customer see my face, people like to see the owner. On weekends, my husband's there and the customers know him. They like to know that we're there. It makes them feel like they're coming to my house. There's a lot of legwork that would need to be done figuring out what fork in the road we take. I have some great employees.

"Maybe there's a way you build a business so that the customer contact for my wholesale customers and then for my retail customers are very different people. The wholesale people are other

business people. But maybe there's a way to build a business where you have one key contact point for your retail customers, the in, the out, the 200 people per day, and then you build the back end dealing with the business customers."

Southport Grocery and Café developed a relationship with Intelligentsia Coffee, a Chicago-based purveyor of fine roasted coffees that has two retail stores in the city. Intelligentsia now carries Southport's cupcakes, a product that has garnered much attention in the food news. Lisa explains how this strategic relationship developed:

"Intelligentsia is the coffee that I wanted to carry to use in the café. So we had a relationship because of that. I've been very blessed with the press, I mean the press loves the store. Every time I turn around, someone was writing an article. I don't have a publicist, I cannot afford one. Those are all priceless things. I mean, we can't afford that kind of advertising. And, as a matter of fact, I think because of that, I don't really advertise all that much. Something's always going on where we're going to be mentioned in some publication. Advertising is hard. It's expensive.

"People latched onto those cupcakes. My husband and I thought for sure it would be the chocolate-chip toffee scones that were going to be the top thing. I think the cupcakes make people feel like they're at home—they're very comforting.

"I worked a little directly with Doug Zell, the co-founder of Intelligentsia Coffee, and then with Marcus Bonnie who heads up the two retail locations. Marcus comes in since he lives in the neighborhood. They love our baked goods. They're going back to their stores wanting more from the baked goods they had been offering their customers. They were buying biscotti frozen in a box from somewhere out west. Then they tried ours and said, 'These are so good!' And so it just was born.

"Then the next thing I know, the Book Cellar in Lincoln Square, she needs food . . . We got hooked up through the Women's Business Development Center of the SBA. . . .

"And it's basically just word of mouth. It's amazing. The small business community,

especially with food, we all know each other. I think for the most part, you all want to help each other. We want each other to succeed. And now Olivia's Market, the new urban grocery store in Bucktown, wants our soups and our baked goods. Starting Monday we're going to be in Millennium Park where people turn in their bikes. I mean, I'm at a point where I can't take any more business.

"And it's not a breaking point from a space issue. I can have people baking in the middle of the night. But it's from a staffing issue. I need to do some analysis around . . . have sort of a step-stone, 'if I hired another baker, what would that level be?' In a way it's all scary because anything you need to do is another investment, but it's a fun business problem to figure out."

Lisa Santos heeds the often advised "listen to your customers" very seriously. "My former boss at CNA taught me something very important. He said 'you tend to always think you know the way to get it done, and you probably do, but the businesses [our internal customers] want to feel some give-and-take.' And I looked at him and said, 'you know Myron, you are right. I know I go in thinking I've cleaned up a thousand messes, just get out of my way!' And he said, 'but you've got to learn to listen.'

"And I look at how Southport Grocery and Café looks today versus how we looked when we opened, even the menu. The evolution is incredible in a year-and-a-half. It's based on customer response. I have a gut check. If I hear it once from a customer, I listen and file it away in my head. If I hear it twice I'm think, 'hmmm, I've heard that twice now.' If I hear it three times from three customers on three different occasions, we have to try it. I read the book, *Crowning the Customer* (by Feargal Quinn), that addresses the balance between doing market research and just testing things out. Without listening, I don't think we would be where we are today, without listening and reacting.

"I would think it's like this in any business, but especially in the kitchen environment. Many people, especially with the prep cooks and the

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dishwashers, have seen a thousand kitchens. We treat them as valued employees because they know stuff, tricks, that I would never know because I'm not immersed in that. So it goes both ways. And the one thing, knock on wood, I've had a lot of turnover in my business—and that's just how the business is, you get a lot of summer help, what have you. But with all the turnover, the turnover in the key positions is a lot less than what is expected. I have two gentlemen in the kitchen now, one who's just been here a year, and one who will be here a year in July. That's unheard of for people who are dishwashers. They've even told me, they've worked at places where the chef or the owner didn't even know their name.

"There was one Sunday where the service in the kitchen was horrible. I was so upset and I thought how do I explain to these guys the fact that they have a variable part of their compensation—they get tips because the kitchen gets tips and retail—they each get part of the pot. And that how they get the food out and how quickly they wash the dishes impacts that. And so, of course being the true business person that I am, balanced scorecard is screaming in my head. So I took a piece of paper while they were cleaning the kitchen and I divided it into four and I had a picture of them on the bottom, then I had a picture of them doing dishes and a picture of the customer and a money bag on the top. It was funny because I'm explaining it to one guy who doesn't speak any English so I have a translator. So here I am, trying to explain to this very diverse workgroup how this is all connected, why it's important. And I kind of felt good. They got it. I try to treat the employees as a critical part of the business. Sometimes they just want me to tell them what they need to do. I don't think it stifles them though because I still get people coming up and saying, 'you know, I used to do it this way somewhere else.' And I welcome that.

"I explain things to them. When they see me going to Restaurant Depot to buy something, they might say, 'oh, we could use some more ramekins.' I say, 'OK guys this is how much

ramekins cost, do we really need them?' They're like, (gasp) it costs that much? And I say, yes. And they know where the business is financially. They know there are months when we still struggle. It's funny how you define if that team is built. It's so different now than when we first opened. When we first opened it was just basic things like, are the coolers stocked and can we open the door? As complex as a small business is, but it's all about time, service and quality and as much cross-training as you can do because if one person's sick, you're in the tank sometimes if you haven't trained someone else. When you go to market, I think it's unrealistic to think that everything is going to be in a row the day you open those doors. But I think that all those things need to be there in your head so you can start moving toward them."

What will Santos be testing out in the near future?

"This is the year of the deli case. My analysis in January very clearly showed me that the prepared food that we have in our open-air cooler, we do very well in. So we bought a deli case. It will be filled by next week. Basically it's a little bit more work in the kitchen but it's got a good margin and I think it's what the customers want—prepared salads, antipasto-type foods. And this is a good time of year to test that out as well. It's also the year to put on-line shopping on our website. You know when you go on our website you can see the names of some of our items. You can go to the Grocery section and it lists all the things, but we don't have [an online] shopping cart. It's amazing how many requests I get for that. People ask, 'So are you set up for shipping yet?' We get calls from people based on our website asking, 'can you ship this out?' And my gut is, if they could just click and send . . . I mean if people are taking the time to call . . .

"My web developer has already done a really good job. If you type in any grocery product that we carry, we show up before the manufacturer's website! We're first! I'm not a technical person. I know there's some sort of name-calling convention, so the infrastructure is there. I'm taking a

little bit of a gamble like if I got 20,000 orders the first day, but we've got a big basement downstairs. We could react. My next analytical step is I want to analyze how much can this 2,000 square foot space get us? That would be model number one. Model number two would be what it would take to be open Mondays, because when I'm there on Mondays there are a lot of people out on the street.

"A lot of people don't work 9–5 Monday through Friday. It's a whole new world out there—I thought everybody worked 9–5!"

"I think the third model will be, and this one I shouldn't show my true colors because I think my gut is right, but I've been proven wrong before. We're open from 8 in the morning until 7 at night. We were open until 9 at night when we first opened and people do not perceive us as a nighttime place. I don't know if it's the name with 'grocery & café.' And I'm not really excited about being open 8 in the morning until 11 at night. But I think I need to do that analysis. I think part of that analysis is an extremely expensive, or some sort of a marketing campaign because it didn't happen naturally . . . I would rather invest in we'll say the fourth model that I will do that says, what will it take to really expand wholesale baking? We like to do business with people like us: small business owners that are excited that they are carrying our stuff."

Santos has even turned down business that didn't feel right:

"There was a restaurant that's more cafeteria-style. They wanted our cookies, had never tasted them. So right then I was like, I want you [to] want my stuff because you are addicted to it! They found us through one of our distributors. My distributor heard them talking and said, 'I know someone who does wonderful baking.' So first of all, red flag, she's never had the stuff. Can they really want it? Number two, it's a national franchise. Number three they're a cafeteria-style so they were going to wrap them in saran wrap by the checkout. It just didn't feel right. The money is good but my gut just said this isn't right. I know

all the other business owners that I sell to. We talk to each other. . . And we've been blessed with being able to use our down-time for the most part, and it pays well more than half my rent."

Santos considers whether her company should focus on the wholesale side of the business in the future.

"Do we take that as our business model, spin off things that we've become experts at—quality driven at—and make it its own business. We could rent some cheap space on Ravenswood, bake out of there, ship to our own store and to whomever else."

Reflecting on the past eighteen months in which she has turned her culinary passion into a thriving business, Lisa Santos says,

"It's been amazing. And trust me there have been nights where I have felt that I've made the biggest mistake of my life. I'm very lucky that I have a very supportive family and husband and friends. And my father is my informal advisor. We're heading in the right direction. The numbers look good for where we're supposed to be, and maybe a little ahead of the curve in terms of a new business. But worst case, what if this doesn't work? I've had the best time of my life trying to make it work! You have a chance to try and test out all of these things you've learned. It doesn't matter what happens, it's worth it."

SOURCE: Interview with Lisa Santos by Lisa Gundry. Reprinted with permission.

## Discussion Questions

1. What are some of the key factors that led to Southport Grocery and Café's success?
2. What are the key challenges and opportunities facing Southport Grocery and Café?
3. What differentiates the business from its competition?
4. What would you advise Lisa Santos to do to grow her business in the future?

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