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THE ENTREPRENEURIAL PERSPECTIVE

CHAPTER 1
Entrepreneurship and the Entrepreneurial Mind-Set

CHAPTER 2
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CHAPTER 3
Entrepreneurial Strategy: Generating and Exploiting New Entrants
LEARNING OBJECTIVES

1. To introduce the concept of entrepreneurship and explain the entrepreneurial process.
2. To introduce effectuation as a way that expert entrepreneurs sometimes think.
3. To develop the notion that entrepreneurs learn to be cognitively adaptable.
4. To acknowledge that some entrepreneurs experience failure and to recognize the process by which they maximize their ability to learn from that experience.
5. To recognize that entrepreneurs have an important economic impact as well as an ethical and social responsibility.
OPENING PROFILE

EWING MARION KAUFFMAN

Born on a farm in Garden City, Missouri, Ewing Marion Kauffman moved to Kansas City with his family when he was eight years old. A critical event in his life occurred several years later when Kauffman was diagnosed with a leakage of the heart. His prescription was one year of complete bed rest; he was not even allowed to sit up. Kauffman's mother, a college graduate, came up with a solution to keep the active 11-year-old boy lying in bed—reading. According to Kauffman, he “sure read! Because nothing else would do, I read as many as 40 to 50 books every month. When you read that much, you read anything. So I read the biographies of all the presidents, the frontiersmen, and I read the Bible twice and that's pretty rough reading.”

Another important early childhood experience centered on door-to-door sales. Since his family did not have a lot of money, Kauffman would sell 36 dozen eggs collected from the farm or fish he and his father had caught, cleaned, and dressed. His mother was very encouraging during these formative school years, telling young Ewing each day, “There may be some who have more money in their pockets, but Ewing, there is nobody better than you.”

During his youth, Kauffman worked as a laundry delivery person and was a Boy Scout. In addition to passing all the requirements to become an Eagle Scout and a Sea Scout, he sold twice as many tickets to the Boy Scout Roundup as anyone else in Kansas City, an accomplishment that enabled him to attend, for free, a two-week scout summer camp that his parents would not otherwise have been able to afford. According to Kauffman, “This experience gave me some of the sales techniques which came into play when subsequently I went into the pharmaceutical business.”

Kauffman went to junior college from 8 to 12 in the morning and then walked two miles to the laundry where he worked until 7 p.m. Upon graduation, he went to work at the laundry full time for Mr. R. A. Long, who would eventually become one of his role models. His job as route foreman involved managing 18 to 20 route drivers, where he would set up sales contests, such as challenging the other drivers to get more customers on a particular route than he could obtain. Ewing says, “I got practice in selling and that proved to be beneficial later in life.” R. A. Long made money not only at the...
laundry business but also on patents, one of which was a form fit for the collar of a shirt that would hold the shape of the shirt. He showed his young protégé that one could make money with brains as well as brawn. Kauffman commented, “He was quite a man and had quite an influence on my life.”

Kauffman’s sales ability was also useful during his stint in the Navy, which he joined shortly after Pearl Harbor on January 11, 1942. When designated as an apprentice seaman, a position that paid $21 per month, he responded, “I’m better than an apprentice seaman, because I have been a sea scout. I’ve sailed ships and I’ve ridden in whale boats.” His selling ability convinced the Navy that he should instead start as a seaman first class, with a $54 monthly salary. Kauffman was assigned to the admiral’s staff, where he became an outstanding signalman (a seaman who transmitted messages from ship to ship), in part because he was able to read messages better than anyone else due to his previous intensive reading. With his admiral’s encouragement, Kauffman took a correspondence navigator’s course and was given a deck commission and made a navigation officer.

After the war was over in 1947, Ewing Kauffman began his career as a pharmaceutical salesperson after performing better on an aptitude test than 50 other applicants. The job involved selling supplies of vitamin and liver shots to doctors. Working on straight commission, without expenses or benefits, he was earning pay higher than the president’s salary by the end of the second year; the president promptly cut the commission. Eventually, when Kauffman was made Midwest sales manager, he made 3 percent of everything his salespeople sold and continued to make more money than the president. When his territory was cut, he eventually quit and in 1950 started his own company—Marion Laboratories. (Marion is his middle name.)

When reflecting on founding the new company, Ewing Kauffman commented, “It was easier than it sounds because I had doctors whom I had been selling office supplies to for several years. Before I made the break, I went to three of them and said, ‘I’m thinking of starting my own company. May I count on you to give me your orders if I can give you the same quality and service?’ These three were my biggest accounts and each one of them agreed because they liked me and were happy to do business with me.”

Marion Laboratories started by marketing injectable products that were manufactured by another company under Marion’s label. The company expanded to other accounts and other products and then developed its first prescription item, Vicam, a vitamin product. The second pharmaceutical product it developed, oyster shell calcium, also sold well.

To expand the company, Kauffman borrowed $5,000 from the Commerce Trust Company. He repaid the loan, and the company continued to grow. After several years, outside investors could buy $1,000 worth of common stock if they loaned the company $1,000 to be paid back in five years at $1,250, without any intermittent interest. This initial $1,000 investment, if held until 1993, would have been worth $21 million.

Marion Laboratories continued to grow and reached over $1 billion per year in sales, due primarily to the relationship between Ewing Kauffman and the people in
the company, who were called associates, not employees. "They are all stockholders, they build this company, and they mean so much to us," said Kauffman. The concept of associates was also a part of the two basic philosophies of the company: Those who produce should share in the results or profits, and treat others as you would like to be treated.

The company went public through Smith Barney on August 16, 1965, at $21 per share. The stock jumped to $28 per share immediately and has never dropped below that level, sometimes selling at a 50 to 60 price/earnings multiple. The associates of the company were offered a profit sharing plan, where each could own stock in the company. In 1968 Kauffman brought Major League Baseball back to Kansas City by purchasing the Kansas City Royals. This boosted the city’s economic base, community profile, and civic pride. When Marion Laboratories merged with Merrill Dow in 1989, there were 3,400 associates, 300 of whom became millionaires as a result of the merger. The new company, Marion Merrill Dow, Inc., grew to 9,000 associates and sales of $4 billion in 1998 when it was acquired by Hoechst, a European pharmaceutical company. Hoechst Marion Roussel became a world leader in pharmaceutical-based health care involved in the discovery, development, manufacture, and sale of pharmaceutical products. In late 1999 the company was again merged with Aventis Pharma, a global pharmaceutical company focusing on human medicines (prescription pharmaceuticals and vaccines) and animal health. In 2002, Aventis’s sales reached $16.634 billion, an increase of 11.6 percent from 2001, while earnings per share grew 27 percent from the previous year.

Ewing Marion Kauffman was an entrepreneur, a Major League Baseball team owner, and a philanthropist who believed his success was a direct result of one fundamental philosophy: Treat others as you would like to be treated. "It is the happiest principle by which to live and the most intelligent principle by which to do business and make money," he said.

Ewing Marion Kauffman’s philosophies of associates, rewarding those who produce, and allowing decision making throughout the organization are the fundamental concepts underlying what is now called corporate entrepreneurship in a company. He went even further and illustrated his belief in entrepreneurship and the spirit of giving back when he established the Kauffman Foundation, which supports programs in two areas: youth development and entrepreneurship. Truly a remarkable entrepreneur, Mr. K, as he was affectionately called by his employees, will now produce many more successful "associate entrepreneurs."

Like Ewing Marion Kauffman, many other entrepreneurs and future entrepreneurs frequently ask themselves, “Am I really an entrepreneur? Do I have what it takes to be a success? Do I have sufficient background and experience to start and manage a new venture?” As enticing as the thought of starting and owning a business may be, the problems and pitfalls inherent to the process are as legendary as the success stories. The fact remains that more new business ventures fail than succeed. To be one of the few successful entrepreneurs requires more than just hard work and luck. It requires the ability to think in an environment of high uncertainty, be flexible, and learn from one’s failures.
Who is an entrepreneur? What is entrepreneurship? What is an entrepreneurial process?

These frequently asked questions reflect the increased national and international interest in entrepreneurs by corporate executives, venture capitalists, university professors and students, recruiters, and government officials. To an economist, an entrepreneur is one who brings resources, labor, materials, and other assets into combinations that make their value greater than before, and also one who introduces changes, innovations, and a new order. To a psychologist, such a person is typically driven by certain forces—the need to obtain or attain something, to experiment, to accomplish, or perhaps to escape the authority of others. To one businessman, an entrepreneur appears as a threat, an aggressive competitor, whereas to another businessman the same entrepreneur may be an ally, a source of supply, a customer, or someone who creates wealth for others, as well as finds better ways to utilize resources, reduce waste, and produce jobs others are glad to get.

Although being an entrepreneur means different things to different people, there is agreement that we are talking about a kind of behavior that includes: (1) initiative taking, (2) the organizing and reorganizing of social and economic mechanisms to bundle resources in innovative ways, and (3) the acceptance of risk, uncertainty and/or the potential for failure.

Entrepreneurship is the dynamic process of creating incremental wealth. The wealth is created by individuals who assume the major risks in terms of equity, time, and/or career commitment to provide value for some product or service. The product or service may or may not be new or unique, but the entrepreneur must somehow infuse value by receiving and bundling the necessary skills and resources.

To be inclusive of the many types of entrepreneurial behavior, the following definition of entrepreneurship will be the foundation of this book:

Entrepreneurship is the process of creating something new with value by devoting the necessary time and effort; assuming the accompanying financial, psychic, and social risks and uncertainties; and receiving the resulting rewards of monetary and personal satisfaction.

This definition stresses four basic aspects of being an entrepreneur. First, entrepreneurship involves the creation process—creating something new of value. The creation has to have value to the entrepreneur and value to the audience for which it is developed. This audience can be (1) the market of organizational buyers for business innovation, (2) the hospital’s administration for a new admitting procedure and software, (3) prospective students for a new course or even college of entrepreneurship, or (4) the constituency for a new service provided by a nonprofit agency. Second, entrepreneurship requires the devotion of the necessary time and effort. Only those going through the entrepreneurial process appreciate the significant amount of time and effort it takes to create something new and make it operational. As one new entrepreneur so succinctly stated, “While I may have worked as many hours in the office while I was in industry, as an entrepreneur I never stop thinking about the business.”

The third part of the definition involves the rewards of being an entrepreneur. The most important of these rewards is independence, followed by personal satisfaction, but monetary reward also comes into play. For some entrepreneurs, money becomes the indicator of the degree of success achieved. Assuming the necessary risks and uncertainties is the final aspect of entrepreneurship. Because action takes place over time, and the future is unknowable, action is inherently uncertain. This uncertainty is further enhanced by the novelty intrinsic to entrepreneurial actions, such as the creation of new products, new services, and new ventures. Entrepreneurs must decide to act even in the face of uncertainty over the outcome of that action. Therefore, entrepreneurs respond to, and create, change through
entrepreneurial action

Refers to behavior in response to a judgmental decision under uncertainty about a possible opportunity for profit.

entrepreneurial process

The process of creating something new with value by devoting the necessary time and effort, assuming the accompanying financial, psychic, and social risks and uncertainties, and receiving the resulting rewards of monetary and personal satisfaction.

opportunity identification

The process by which an entrepreneur comes up with the opportunity for a new venture.

their entrepreneurial actions, where entrepreneurial action refers to behavior in response to a judgmental decision under uncertainty about a possible opportunity for profit. We now offer a process perspective of entrepreneurial action.

THE ENTREPRENEURIAL PROCESS

The process of pursuing a new venture is embodied in the entrepreneurial process, which involves more than just problem solving in a typical management position. An entrepreneur must find, evaluate, and develop an opportunity by overcoming the forces that resist the creation of something new. The process has four distinct phases: (1) identification and evaluation of the opportunity, (2) development of the business plan, (3) determination of the required resources, and (4) management of the resulting enterprise (see Table 1.1).

Although these phases proceed progressively, no one stage is dealt with in isolation or is totally completed before work on other phases occurs. For example, to successfully identify and evaluate an opportunity (phase 1), an entrepreneur must have in mind the type of business desired (phase 4).

Identify and Evaluate the Opportunity

Opportunity identification and evaluation is a very difficult task. Most good business opportunities do not suddenly appear, but rather result from an entrepreneur’s alertness to possibilities or, in some cases, the establishment of mechanisms that identify potential opportunities. For example, one entrepreneur asks at every cocktail party whether anyone is using a product that does not adequately fulfill its intended purpose. This person is constantly looking for a need and an opportunity to create a better product. Another entrepreneur

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TABLE 1.1 Aspects of the Entrepreneurial Process
always monitors the play habits and toys of her nieces and nephews. This is her way of looking for any unique toy product niche for a new venture.

Although most entrepreneurs do not have formal mechanisms for identifying business opportunities, some sources are often fruitful: consumers and business associates, members of the distribution system, and technical people. Often, consumers are the best source of ideas for a new venture. How many times have you heard someone comment, “If only there was a product that would …” This comment can result in the creation of a new business. One entrepreneur’s evaluation of why so many business executives were complaining about the lack of good technical writing and word-processing services resulted in the creation of her own business venture to fill this need. Her technical writing service grew to 10 employees in two years.

Because of their close contact with the end user, channel members in the distribution system also see product needs. One entrepreneur started a college bookstore after hearing all the students complain about the high cost of books and the lack of service provided by the only bookstore on campus. Many other entrepreneurs have identified business opportunities through a discussion with a retailer, wholesaler, or manufacturer’s representative. Finally, technically oriented individuals often conceptualize business opportunities when working on other projects. One entrepreneur’s business resulted from seeing the application of a plastic resin compound in developing and manufacturing a new type of pallet while developing the resin application in another totally unrelated area—casket moldings.

Whether one identifies the opportunity by using input from consumers, business associates, channel members, or technical people, each opportunity must be carefully screened and evaluated. This evaluation of the opportunity is perhaps the most critical element of the entrepreneurial process, as it allows the entrepreneur to assess whether the specific product or service has the returns needed compared to the resources required. As indicated in Table 1.1, this evaluation process involves looking at the length of the opportunity, its real and perceived value, its risks and returns, its fit with the personal skills and goals of the entrepreneur, and its uniqueness or differential advantage in its competitive environment.

The market size and the length of the window of opportunity are the primary bases for determining the risks and rewards. The risks reflect the market, competition, technology, and amount of capital involved. The amount of capital needed provides the basis for the return and rewards. The methodology for evaluating risks and rewards, the focus of Chapters 7 and 10, frequently indicates that an opportunity offers neither a financial nor a personal reward commensurate with the risks involved. One company that delivered bark mulch to residential and commercial users for decoration around the base of trees and shrubs added loam and shells to its product line. These products were sold to the same customer base using the same distribution (delivery) system. Follow-on products are important for a company expanding or diversifying in a particular channel. A distribution channel member such as Kmart, Service Merchandise, or Target prefers to do business with multi-product, rather than single-product, firms.

Finally, the opportunity must fit the personal skills and goals of the entrepreneur. It is particularly important that the entrepreneur be able to put forth the necessary time and effort required to make the venture succeed. Although many entrepreneurs feel that the desire can be developed along with the venture, typically it does not materialize. An entrepreneur must believe in the opportunity so much that he or she will make the necessary sacrifices to develop the opportunity and manage the resulting organization.

Opportunity analysis, or what is frequently called an opportunity assessment plan, is one method for evaluating an opportunity. It is not a business plan. Compared to a business plan, an opportunity assessment plan is much shorter and more focused. The plan simply provides a framework for assessing the opportunity and its potential.

**Table 1.1: Window of Opportunity**

- The time period available for creating the new venture.
- The availability of resources to support the new venture.
- The potential for success in the new venture.
- The potential for growth and profitability in the new venture.
- The potential for finding a market for the new venture.
- The potential for finding a distribution channel for the new venture.

**Figure 1.4: The Entrepreneurial Process**

1. **Opportunity Identification**: This stage involves identifying the opportunity that aligns with the entrepreneur’s skills and goals.
2. **Opportunity Evaluation**: This stage involves assessing the feasibility of the opportunity and determining whether it is worth pursuing.
3. **Opportunity Development**: This stage involves developing the business plan and preparing for the launch of the new venture.
4. **Opportunity Implementation**: This stage involves launching the new venture and managing its growth.

**Figure 1.5: The Entrepreneurial Process Flowchart**

- **Opportunity Identification**: The entrepreneur identifies an opportunity that aligns with their skills and goals.
- **Opportunity Evaluation**: The entrepreneur evaluates the opportunity to determine its feasibility and potential.
- **Opportunity Development**: The entrepreneur develops a business plan and prepares for the launch.
- **Opportunity Implementation**: The entrepreneur launches the new venture and manages its growth.
An opportunity assessment plan includes the following: a description of the product or service, an assessment of the opportunity, an assessment of the entrepreneur and the team, specifications of all the activities and resources needed to translate the opportunity into a viable business venture, and the source of capital to finance the initial venture as well as its growth. The assessment of the opportunity requires answering the following questions:

- What market need does it fill?
- What personal observations have you experienced or recorded with regard to that market need?
- What social condition underlies this market need?
- What market research data can be marshaled to describe this market need?
- What patents might be available to fulfill this need?
- What competition exists in this market? How would you describe the behavior of this competition?
- What does the international market look like?
- What does the international competition look like?
- Where is the money to be made in this activity?

Develop a Business Plan

A good business plan must be developed to exploit the defined opportunity. For example, a business plan is often required to obtain the resources necessary to launch the business. Writing a business plan is a very time consuming phase of the entrepreneurial process. An entrepreneur usually has not prepared a business plan before and does not have the resources available to do a good job. Although the preparation of the business plan is the focus of Chapter 7, it is important to understand the basic issues involved as well as the three major sections of the plan (see Table 1.1). A good business plan is essential to developing the opportunity and determining the resources required, obtaining those resources, and successfully managing the resulting venture.

Determine the Resources Required

The entrepreneur must determine the resources needed for addressing the opportunity. This process starts with an appraisal of the entrepreneur’s present resources. Any resources that are critical need to be differentiated from those that are just helpful. Care must be taken not to underestimate the amount and variety of resources needed. The entrepreneur should also assess the downside risks associated with insufficient or inappropriate resources.

The next step in the entrepreneurial process is acquiring the needed resources in a timely manner while giving up as little control as possible. An entrepreneur should strive to maintain as large an ownership position as possible, particularly in the start-up stage. As the business develops, more funds will probably be needed to finance the growth of the venture, requiring more ownership to be relinquished. The entrepreneur also needs to identify alternative suppliers of these resources, the focus of Chapter 11, along with their needs and desires. By understanding resource supplier needs, the entrepreneur can structure a deal that enables the resources to be acquired at the lowest possible cost and with the least loss of control.
Manage the Enterprise

After resources are acquired, the entrepreneur must use them to implement the business plan. The operational problems of the growing enterprise must also be examined. This involves implementing a management style and structure, as well as determining the key variables for success. A control system must be established so that any problem areas can be quickly identified and resolved. Some entrepreneurs have difficulty managing and growing the venture they created.

HOW ENTREPRENEURS THINK

Entrepreneurs think differently than nonentrepreneurs. Moreover, an entrepreneur in a particular situation may think differently when faced with a different task or decision environment. Entrepreneurs must often make decisions in highly uncertain environments where the stakes are high, time pressures are immense, and there is considerable emotional investment. We think differently in these environments than we do when the nature of a problem is well understood and we have time and rational procedures at hand to solve it. Given the nature of an entrepreneur’s decision-making environment, he or she must sometimes (1) effectuate, (2) be cognitively adaptable, and (3) learn from failure. We now discuss the thought process behind each of these requirements.

Effectuation

As potential business leaders you are trained to think rationally and perhaps admonished if you do not. This admonishment might be appropriate given the nature of the task, but it appears that there is an alternate way of thinking that entrepreneurs sometimes use, especially when thinking about opportunities. Professor Saras Sarasvathy (from Darden, University of Virginia) has found that entrepreneurs do not always think through a problem in a way that starts with a desired outcome and focuses on the means to generate that outcome. Such a process is referred to as a causal process. Our description of the entrepreneurial process in the preceding section reflects a causal explanation. But, entrepreneurs sometimes use an effectuation process, which means they take what they have (who they are, what they know, and whom they know) and select among possible outcomes. Professor Saras is a great cook, so it is not surprising that her examples of these thought processes revolve around cooking.

Imagine a chef assigned the task of cooking dinner. There are two ways the task can be organized. In the first, the host or client picks out a menu in advance. All the chef needs to do is list the ingredients needed, shop for them, and then actually cook the meal. This is a process of causation. It begins with a given menu and focuses on selecting between effective ways to prepare the meal.

In the second case, the host asks the chef to look through the cupboards in the kitchen for possible ingredients and utensils and then cook a meal. Here, the chef has to imagine possible menus based on the given ingredients and utensils, select the menu, and then prepare the meal. This is a process of effectuation. It begins with given ingredients and utensils and focuses on preparing one of many possible desirable meals with them.

Sarasvathy’s Thought Experiment #1: Curry in a Hurry

In this example I [Sarasvathy] trace the process for building an imaginary Indian restaurant, “Curry in a Hurry.” Two cases, one using causation and the other effectuation, are examined. For the purposes of this illustration, the example chosen is a typical causation process that
underlies many economic theories today—theories in which it is argued that artifacts such as firms are inevitable outcomes, given the preference orderings of economic actors and certain simple assumptions of rationality (implying causal reasoning) in their choice behavior. The causation process used in the example here is typified by and embodied in the procedures stated by Philip Kotler in his *Marketing Management* (1991: 63, 263), a book that in its many editions is considered a classic and is widely used as a textbook in MBA programs around the world. Kotler defines a market as follows: "A market consists of all the potential customers sharing a particular need or want who might be willing and able to engage in exchange to satisfy that need or want" (1991: 63). Given a product or a service, Kotler suggests the following procedure for bringing the product/service to market (note that Kotler assumes the market exists):

1. Analyze long-run opportunities in the market.
2. Research and select target markets.
3. Identify segmentation variables and segment the market.
4. Develop profiles of resulting segments.
5. Evaluate the attractiveness of each segment.
6. Select the target segment(s).
7. Identify possible positioning concepts for each target segment.
8. Select, develop, and communicate the chosen positioning concept.
10. Plan marketing programs.
11. Organize, implement, and control marketing effort.

This process is commonly known in marketing as the STP—segmentation, targeting, and positioning—process. Kotler defines a market as follows: "A market consists of all the potential customers sharing a particular need or want who might be willing and able to engage in exchange to satisfy that need or want" (1991: 63). Given a product or a service, Kotler suggests the following procedure for bringing the product/service to market (note that Kotler assumes the market exists):

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Curry in a Hurry is a restaurant with a new twist—say, an Indian restaurant with a fast food section. The current paradigm using causation processes indicates that, to implement this idea, the entrepreneur should start with a universe of all potential customers. Let us imagine that she wants to build her restaurant in Pittsburgh, Pennsylvania, USA, which will then become the initial universe or market for Curry in a Hurry. Assuming that the percentage of the population of Pittsburgh that totally abhors Indian food is negligible, the entrepreneur can start the STP process.

Several relevant segmentation variables, such as demographics, residential neighborhoods, ethnic origin, marital status, income level, and patterns of eating out, could be used. On the basis of these, the entrepreneur could send out questionnaires to selected neighborhoods and organize focus groups at, say, the two major universities in Pittsburgh. Analyzing responses to the questionnaires and focus groups, she could arrive at a target segment—for example, wealthy families, both Indian and others, who eat out at least twice a week. That would help her determine her menu choices, decor, hours, and other operational details. She could then design marketing and sales campaigns to induce her target segment to try her restaurant. She could also visit other Indian and fast food restaurants and find some method of surveying them and then develop plausible demand forecasts for her planned restaurant.

In any case, the process would involve considerable amounts of time and analytical effort. It would also require resources both for research and, thereafter, for implementing the marketing strategies. In summary, the current paradigm suggests that we proceed inward to specifics from a larger, general universe—that is, to an optimal target segment from a predetermined market. In terms of Curry in a Hurry, this could mean something like a progression from the entire city of Pittsburgh to Fox Chapel (an affluent residential neighborhood) to the Joneses (specific customer profile of a wealthy family), as it were.

Instead, if our imaginary entrepreneur were to use processes of effectuation to build her restaurant, she would have to proceed in the opposite direction (note that effectuation is suggested here as a viable and descriptively valid alternative to the STP process—not as a
normatively superior one). For example, instead of starting with the assumption of an existing market and investing money and other resources to design the best possible restaurant for the given market, she would begin by examining the particular set of means or causes available to her. Assuming she has extremely limited monetary resources—say $20,000—she should think creatively to bring the idea to market with as close to zero resources as possible. She could do this by convincing an established restaurateur to become a strategic partner or by doing just enough market research to convince a financier to invest the money needed to start the restaurant. Another method of effectuation would be to convince a local Indian restaurant or a local fast food restaurant to allow her to put up a counter where she would actually sell a selection of Indian fast food. Selecting a menu and honing other such details would be seat-of-the-pants and tentative, perhaps a process of satisficing.

Several other courses of effectuation can be imagined. Perhaps the course the entrepreneur actually pursues is to contact one or two of her friends or relatives who work downtown and bring them and their office colleagues some of her food to taste. If the people in the office like her food, she might get a lunch delivery service going. Over time, she might develop enough of a customer base to start a restaurant or else, after a few weeks of trying to build the lunch business, she might discover that the people who said they enjoyed her food did not really enjoy it so much as they did her quirky personality and conversation, particularly her rather unusual life perceptions. Our imaginary entrepreneur might now decide to give up the lunch business and start writing a book, going on the lecture circuit and eventually building a business in the motivational consulting industry!

Given the exact same starting point—but with a different set of contingencies—the entrepreneur might end up building one of a variety of businesses. To take a quick tour of some possibilities, consider the following: Whoever first buys the food from our imaginary Curry in a Hurry entrepreneur becomes, by definition, the first target customer. By continually listening to the customer and building an ever-increasing network of customers and strategic partners, the entrepreneur can then identify a workable segment profile. For example, if the first customers who actually buy the food and come back for more are working women of varied ethnic origin, this becomes her target segment. Depending on what the first customer really wants, she can start defining her market. If the customer is really interested in the food, the entrepreneur can start targeting all working women in the geographic location, or she can think in terms of locating more outlets in areas with working women of similar profiles—a “Women in a Hurry” franchise?

Or, if the customer is interested primarily in the idea of ethnic or exotic entertainment, rather than merely in food, the entrepreneur might develop other products, such as catering services, party planning, and so on—“Curry Favors!” Perhaps, if the customers buy food from her because they actually enjoy learning about new cultures, she might offer lectures and classes, maybe beginning with Indian cooking and moving on to cultural aspects, including concerts and ancient history and philosophy, and the profound idea that food is a vehicle of cultural exploration—“School of Curry”? Or maybe what really interests them is theme tours and other travel options to India and the Far East—“Curryland Travels”?

In a nutshell, in using effectuation processes to build her firm, the entrepreneur can build several different types of firms in completely disparate industries. This means that the original idea (or set of causes) does not imply any one single strategic universe for the firm (or effect). Instead, the process of effectuation allows the entrepreneur to create one or more several possible effects irrespective of the generalized end goal with which she started. The process not only enables the realization of several possible effects (although generally one or only a few are actually realized in the implementation) but it also allows a decision maker to change his or her goals and even to shape and construct them over time, making use of contingencies as they arise.11

Our use of direct quotes from Sarasvathy on effectuation is not to make the case that it is superior to thought processes that involve causation; rather, it represents a way that entrepreneurs sometimes think. Effectuation helps entrepreneurs think in an environment of
Given the nature of this type of environment, most managers of firms need to take on an entrepreneurial mind-set so that their firms can successfully adapt to environmental changes. This entrepreneurial mind-set involves the ability to rapidly sense, act, and mobilize, even under uncertain conditions. In developing an entrepreneurial mind-set, individuals must attempt to make sense of opportunities in the context of changing goals, constantly questioning one’s “dominant logic” in the context of a changing environment, and revisiting “deceptively simple questions” about what we think to be true about markets and the firm. For example, effective entrepreneurs are thought to continuously “rethink current strategic actions, organization structure, communications systems, corporate culture, asset deployment, investment strategies, in short every aspect of a firm’s operation and long-term health.”

To be good at these tasks individuals must develop a cognitive adaptability. Mike Haynie, a retired major of the U.S. Air Force and now professor at Syracuse University, has developed a number of models of cognitive adaptability and a survey for capturing it, to which we now turn.

Cognitive Adaptability

Cognitive adaptability describes the extent to which entrepreneurs are dynamic, flexible, self-regulating, and engaged in the process of generating multiple decision frameworks focused on sensing and processing changes in their environments and then acting on them. Decision frameworks are organized prior knowledge about people and situations that are used to help someone make sense of what is going on. Cognitive adaptability is reflected in an entrepreneur’s metacognitive awareness, that is, the ability to reflect upon, understand, and control one’s thinking and learning. Specifically, metacognition describes a higher-order cognitive process that serves to organize what individuals know and recognize about themselves, tasks, situations, and their environments to promote effective and adaptable cognitive functioning in the face of feedback from complex and dynamic environments.

How cognitively adaptable are you? Try the survey in Table 1.2 and compare yourself to some of your classmates. A higher score means that you are more metacognitively aware and this in turn helps provide cognitive adaptability. Regardless of your score, the good news is that you can learn to be more cognitively adaptable. This ability will serve you well in most new tasks, but particularly when pursuing a new entry and managing a firm in an uncertain environment. Put simply, it requires us to ‘think about thinking which requires, and helps provide, knowledge and control over our thinking and learning activities—it requires us to be self-aware, to think aloud, to reflect, to be strategic, to plan, to have a plan in mind, to know what to know, to self-monitor.’ We can achieve this by asking ourselves a series of questions that relate to (1) comprehension, (2) connection, (3) strategy, and (4) reflection.

1. Comprehension questions are designed to increase entrepreneurs’ understanding of the nature of the environment before they begin to address an entrepreneurial challenge, whether it be a change in the environment or the assessment of a potential opportunity. Understanding arises from recognition that a problem or opportunity exists, the nature of that situation, and its implications. In general, the questions that stimulate individuals to think about comprehension include: What is the problem all about? What is the question? What are the meanings of the key concepts? Specific to entrepreneurs, the
WHAT ME WORRY? HOW SMART ENTREPRENEURS HARNESS THE POWER OF PARANOIA

Depending on who you’re talking to, paranoia is: (1) a psychotic disorder characterized by delusions of persecution, (2) an irrational distrust of others, or (3) a key trait in entrepreneurial success.

Sound crazy? Not according to Andrew S. Grove, president and CEO of Intel Corp. in Santa Clara, California, and author of Only the Paranoid Survive. The title of Grove’s book comes from an oft-repeated quote that has become the mantra of the chip king’s rise to the top of the technology business.

“I have no idea when I first said this,” Grove writes, “but the fact remains that, when it comes to business, I believe in the value of paranoia.” To those who suffer from clinical delusions of persecution, of course, paranoia is neither a joke nor a help. However, in a business context, the practice of voluntarily being highly concerned about potential threats to your company has something of a following.

“If you’re not a little paranoid, you’re complacent,” says Dave Lakhani, an entrepreneur in Boise, Idaho, who offers marketing consulting to small businesses. “And complacency is what leads people into missed opportunities and business failure.”

PICK YOUR PARANOIA

Being paranoid, according to Grove, is a matter of remembering that others want the success you have, paying attention to the details of your business, and watching for the trouble that inevitably awaits. That basically means he is paranoid about everything. “I worry about products getting screwed up, and I worry about products getting introduced prematurely,” Grove writes. “I worry about factories not performing well, and I worry about having too many factories.”

For Grove, as for most advocates of paranoia, being paranoid primarily consists of two things. The first is not resting on your laurels. Grove calls it a “guardian attitude” and in Intel, he attempts to nurture in employees a sense of close attention to the fine points.

As an example of paranoia’s value in practice, Lakhani recalls when sales began slowly slumping at a retail store he once owned. He could have dismissed it as a mere blip. Instead, he worried and watched until he spotted a concrete cause. “It turned out one of my employees had developed a negative attitude, and it was affecting my business,” Lakhani says. “As soon as I let him go, sales went back up.”

The main focuses of most entrepreneurs’ paranoia, however, are not so much everyday internal details as major competitive threats and missed opportunities. Situations in which competition and opportunity are both at high levels are called “strategic inflection points” by Grove, and it is during these times, typically when technology is changing, that his paranoia is sharpest.

Paranoia is frequently a welcome presence at major client presentations for Katharine Paine, founder and CEO of The Delahaye Group Inc. In the past, twinges of seemingly unfounded worry have caused Paine to personally attend sales pitches where she learned of serious problems with the way her firm was doing business, she says. The head of the 50-person Portsmouth, New Hampshire, marketing evaluation research firm traces her paranoid style to childhood days spent pretending to be an Indian tracking quarry through the forest. When she makes mental checklists about things that could go wrong or opportunities that could be missed, she’s always keeping an eye out for the business equivalent of a bent twig. “If you are paranoid enough, if you’re good enough at picking up all those clues, you don’t have to just react,” says Paine, “you get to proact and be slightly ahead of the curve.”

PARANOID PARAMETERS

There is, of course, such a thing as being too paranoid. “There are times when it doesn’t make any sense,” acknowledges Lakhani. Focusing on details to the point of spending $500 in accounting fees to find a $5 error is one example of misplaced paranoia. Worrying obsessively about what every competitor is doing or what every potential customer is thinking is also a warning sign, he says. Lack of balance with interests outside the business may be another. “If your whole life is focused around your work, and that’s
Lakhani says. For Paine, failing to act is a sign that you’re going past beneficial paranoia into hurtful fear. “Fear inaction—absolute death for an entrepreneur,” she says. “If we feared the loss of a paycheck or feared entering a new market, none of our businesses would have gotten off the ground.”

All this may be especially true for small-business owners. While paranoia may be appropriate for heads of far-flung enterprises, some say entrepreneurs are already too paranoid. It’s all too easy for entrepreneurs to take their desire for independence and self-determination and turn it into trouble, says Robert Barbato, director of the Small Business Institute at the Rochester Institute of Technology in Rochester, New York. Typically, entrepreneurs take the attitude that “nobody cares as much about this business as I do” and hurtful paranoia toward employees, he says. “They’re seeing ghosts where ghosts don’t exist,” warns Barbato.

That’s especially risky when it comes to dealing with employees. Most people—not just entrepreneurs—do their work for the sense of accomplishment, not because they are plotting to steal their employer’s success, Barbato says. He acknowledges this may be a difficult concept for competition-crazed entrepreneurs—especially those who themselves have been employees who own their own business to move up the ranks. Barbato notes, entrepreneurs must learn to trust and delegate if their businesses are to grow.

PRACTICAL PARANOIA

No matter how useful it is, paranoia may be too loaded a label for some entrepreneurs. If so, critical evaluation or critical analysis are the preferred terms of Stephen Markowitz, director of governmental and political relations of the Small Business Association of Delaware Valley, a 5,000-member trade group. The distinction is more than name-deep. “When I say ‘critically evaluate,’ that means look at everything,” Markowitz explains. “If you’re totally paranoid, the danger is not being able to critically evaluate everything.”

For example, Markowitz says a small retailer threatened by the impending arrival of a superstore in the market would be better served by critically evaluating the potential for benefit as well as harm, instead of merely worrying about it. “If you’re paranoid,” he says, “you’re not going to critically evaluate how it might help you.”

Whatever name it goes by, few entrepreneurs are likely to stop worrying anytime soon. In fact, experience tends to make them more confirmed in their paranoia as they go along. Paine recalls the time a formless fear led her to insist on going to a client meeting where no trouble was expected. She lost the account anyway. “The good news is, my paranoia kicked in,” she says. “The bad news is, it was too late. That made me much more paranoid in the future.”

ADVICE TO AN ENTREPRENEUR

A friend who has just become an entrepreneur has read the above article and comes to you for advice:

1. I worry about my business, does that mean that I am paranoid?
2. What are the benefits of paranoia and what are the costs?
3. How do I know I have the right level of paranoia to effectively run the business and not put me in the hospital with a stomach ulcer?
4. Won’t forcing myself to be more paranoid take the fun out of being an entrepreneur?

TABLE 1.2 Mike Haynie’s “Measure of Adaptive Cognition”

<table>
<thead>
<tr>
<th>How Cognitively Flexible Are You? On a scale of 1 to 10, where 1 is “not very much like me,” and 10 is “very much like me,” how do you rate yourself on the following statements?</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Goal Orientation</strong></td>
</tr>
<tr>
<td>I often define goals for myself.</td>
</tr>
<tr>
<td>I understand how accomplishment of a task relates to my goals.</td>
</tr>
<tr>
<td>I set specific goals before I begin a task.</td>
</tr>
<tr>
<td>I ask myself how well I’ve accomplished my goals once I’ve finished.</td>
</tr>
<tr>
<td>When performing a task, I frequently assess my progress against my objectives.</td>
</tr>
<tr>
<td><strong>Metacognitive Knowledge</strong></td>
</tr>
<tr>
<td>I think of several ways to solve a problem and choose the best one.</td>
</tr>
<tr>
<td>I challenge my own assumptions about a task before I begin.</td>
</tr>
<tr>
<td>I think about how others may react to my actions.</td>
</tr>
<tr>
<td>I find myself automatically employing strategies that have worked in the past.</td>
</tr>
<tr>
<td>I perform best when I already have knowledge of the task.</td>
</tr>
<tr>
<td>I create my own examples to make information more meaningful.</td>
</tr>
<tr>
<td>I try to use strategies that have worked in the past.</td>
</tr>
<tr>
<td>I ask myself questions about the task before I begin.</td>
</tr>
<tr>
<td>I try to translate new information into my own words.</td>
</tr>
<tr>
<td>I try to break problems down into smaller components.</td>
</tr>
<tr>
<td>I focus on the meaning and significance of new information.</td>
</tr>
<tr>
<td><strong>Metacognitive Experience</strong></td>
</tr>
<tr>
<td>I think about what I really need to accomplish before I begin a task.</td>
</tr>
<tr>
<td>I use different strategies depending on the situation.</td>
</tr>
<tr>
<td>I organize my time to best accomplish my goals.</td>
</tr>
</tbody>
</table>
I am good at organizing information.
I know what kind of information is most important to consider when faced with a problem.
I consciously focus my attention on important information.
My "gut" tells me when a given strategy I use will be most effective.
I depend on my intuition to help me formulate strategies.

**Metacognitive Choice**
I ask myself if I have considered all the options when solving a problem.
I ask myself if there was an easier way to do things after I finish a task.
I ask myself if I have considered all the options after I solve a problem.
I re-evaluate my assumptions when I get confused.
I ask myself if I have learned as much as I could have after I finish the task.

**Monitoring**
I periodically review to help me understand important relationships.
I stop and go back over information that is not clear.
I am aware of what strategies I use when engaged in a given task.
I find myself analyzing the usefulness of a given strategy while engaged in a given task.
I find myself pausing regularly to check my comprehension of the problem or situation at hand.
I ask myself questions about how well I am doing while I am performing a novel task. I stop and re-read when I get confused.

---
A higher score means that you are more aware of the way that you think about how you make decisions and are therefore more likely to be cognitively flexible.


---

**Result**

- A higher score means that you are more aware of the way that you think about how you make decisions and are therefore more likely to be cognitively flexible.

---

Solved? Why? How is this problem different from what I have already solved? Why?

Specific to entrepreneurs, the questions are more likely to include: How is this new environment similar to others in which I have operated? How is it different? How is this new organization similar to the established organizations I have managed? How is it different?
3. **Strategic tasks** are designed to stimulate entrepreneurs to think about which strategies are appropriate for solving the problem (and why) or pursuing the opportunity (and how). These tasks prompt them to think about the what, why, and how of their approach to the situation. Generally, these questions include: What strategy/tactic/principle can I use to solve this problem? Why is this strategy/tactic/principle the most appropriate one? How can I organize the information to solve the problem? How can I implement the plan? Specific to entrepreneurs, the questions are likely to include: What changes to strategic position, organizational structure, and culture will help us manage our newness? How can the implementation of this strategy be made feasible?

4. **Reflection tasks** are designed to stimulate entrepreneurs to think about their understanding and feelings as they progress through the entrepreneurial process. These tasks prompt entrepreneurs to generate their own feedback (create a feedback loop in their solution process) to provide the opportunity to change. Generally, reflection questions include: What am I doing? Does it make sense? What difficulties am I facing? How do I feel? How can I verify the solution? Can I use another approach for solving the task? Specific to the entrepreneurial context, entrepreneurs might ask: What difficulties will we have in convincing our stakeholders? Is there a better way to implement our strategy? How will we know success if we see it?

Entrepreneurs who are able to increase cognitive adaptability have an improved ability to (1) adapt to new situations—i.e., it provides a basis by which a person’s prior experience and knowledge affect learning or problem solving in a new situation; (2) be creative—i.e., it can lead to original and adaptive ideas, solutions, or insights; and (3) communicate one’s reasoning behind a particular response. We hope that this section of the book has not only provided you a deeper understanding of how entrepreneurs can think and act with great flexibility, but also an awareness of some techniques for incorporating cognitive adaptability in your life.

We have discussed how entrepreneurs make decisions in uncertain environments and how one might develop an ability to be more cognitively flexible. It is important to note that entrepreneurs operate in such uncertain environments because that is where the opportunities for new entry are to be found and/or generated. There is the possibility that opportunities exist in more stable environments, but even in this situation the entrepreneur’s new entry may create industry instability and uncertainty. Given the inherent uncertainty in entrepreneurial action, there is the possibility that an entrepreneur will experience failure. Failure can be valuable if the entrepreneur is able to learn from it. We now investigate the process of learning from business failure.

**Learning from Business Failure**

Businesses fail. In 2008, a total of 6,513 U.S. firms filed for Chapter 11 bankruptcy (Chapter 11 provides for a business to continue operations while formulating a plan to repay its creditors) and 21,372 U.S. firms filed for Chapter 7 bankruptcy (Chapter 7 is designed to allow individuals to keep certain exempt property while the remaining property is sold to repay creditors) (www.uscourts.gov). Business failure occurs when a fall in revenue and/or a rise in expense is of such magnitude that the firm becomes insolvent and is unable to attract new debt or equity funding; consequently, it cannot continue to operate under the current ownership and management. Projects also fail, such as failure of a new product development effort, the entry into a new market, or an alliance with a former partner.
failure is particularly common among entrepreneurial firms because the newness that is the source of an opportunity is also a source of uncertainty and changing conditions.

Although there are many causes of failure, the most common is insufficient experience. That is, entrepreneurs who have more experience will possess the knowledge to perform more effectively the roles and tasks necessary for success. This experience need not come solely from success. In fact, it appears that we may learn more from our failures than our successes.

A leading entrepreneurship scholar, Rita McGrath, has argued that because entrepreneurs typically seek success and try to avoid failure for their projects, errors are introduced that can not only inhibit the learning and interpretation processes but also make project failure more likely or expensive than necessary. She proposes that there are benefits to be gained from the pursuit of risky opportunities, even if that pursuit increases the potential for failure. This entrepreneurial process of experimentation generates improvements in technologies.

Although Professor McGrath focuses on the failure of projects within a firm, it appears that the process of learning from failure also benefits society through the application of that knowledge to subsequent businesses. Other businesses can learn from an entrepreneur’s mistake and that learning can help our economy.

Does failure always lead to learning? Perhaps, but it would seem that the issue is more complex. The motivation for managing one’s own business or the creation of a new project is typically not simply one of personal profit but also loyalty to a product, loyalty to a market and customers, personal growth, and the need to prove oneself. Some entrepreneurs use their ventures to “create a product that flows from their own internal desires and needs. They create primarily to express subjective conceptions of beauty, emotion, or some aesthetic ideal.”

For members of a family business, the firm may not only be a source of income but also a context for family activity and the embodiment of family pride and identity. This suggests that the loss of a business is likely to generate a negative emotional response from the entrepreneur.

One entrepreneur that I know exhibited a number of worrying emotions when his family business failed. There was numbness and disbelief that this business he had created 20 odd years ago was no longer alive. There was some anger toward the economy, competitors, and debtors. A stronger emotion than anger was that of guilt and self-blame. He felt guilty that he had caused the failure of the business, that it could no longer be passed on to his children, and that as a result he had failed not only as a businessperson but also as a father. These feelings caused him distress and anxiety. He felt the situation was hopeless, became withdrawn, and at times depressed. These are all strong negative emotions. After the failure of their businesses or projects, it is likely that most entrepreneurs feel a negative emotional response to that loss.

This negative emotional reaction can interfere with entrepreneurs’ ability to learn from failure and quite possibly their motivation to try again. For entrepreneurs, learning from failure occurs when they can use the information available about why the venture failed (feedback information) to revise their existing knowledge of how to manage their ventures more effectively (entrepreneurial knowledge)—that is, revise assumptions about the consequences of previous assessments, decisions, actions, and inactions. For example, Ravi Kalakota has learned a number of lessons from the failure of his business, Hsupply.com, such as, “Don’t let venture capitalists hijack your vision,” “Don’t rapidly burn through capital to achieve short-term growth,” and “Don’t underestimate the speed others will imitate your products and services.”
Indeed, negative emotions have been found to interfere with individuals’ allocation of attention in the processing of information. Such interference negatively impacts their ability to learn from negative events. For the entrepreneur, this could mean focusing attention on the day that the business closed (i.e., dwelling on announcements to employees, buyers, and suppliers, as well as handing over the office keys to a liquidator), rather than allocating sufficient attention on feedback information, such as previous actions and/or inactions that caused the deterioration in business performance and ultimately the loss of the business.

Recovery and Learning Process

An individual has emotionally recovered from the failure when thoughts about the events surrounding, and leading up to, the loss of the business no longer generate a negative emotional response. The two primary descriptions of the process of recovering from feelings arising from failure are classifiable as either loss-oriented or restoration-oriented.

Loss-orientation refers to working through, and processing, some aspect of the loss experience and, as a result of this process, breaking emotional bonds to the object lost. This process of constructing a series of accounts about the loss gradually provides the loss with meaning and eventually produces a changed viewpoint of the self and the world. Changing the way that an event is interpreted can allow an entrepreneur to regulate emotions so that thoughts of the event no longer generate negative emotions. Entrepreneurs with a loss-orientation might seek out friends, family, or psychologists to talk about their negative feelings. But they may also focus their thoughts on the time spent in creating and nurturing the business and may ruminate about the circumstances and events surrounding the loss. It appears that such thoughts could evoke a sense of yearning for the way things used to be or foster a sense of relief that the events surrounding the loss (e.g., arguing with creditors, explaining to employees, family, and friends the business has failed) are finally over. While these feelings of relief and pain wax and wane over time, in the early periods after the failure, painful memories are likely to dominate.

Restoration-orientation is based on both avoidance and a proactiveness toward secondary sources of stress arising from a major loss. A restoration-orientation is not simply about avoidance, however; it also involves the way that an entrepreneur attends to other aspects of his or her life (e.g., coping with daily life, learning new tasks). It refers to being proactive toward secondary sources of stress instead of being concerned with the loss itself. Such activities enable entrepreneurs to distract themselves from thinking about the loss while simultaneously maintaining essential activities necessary for restructuring aspects of their lives. This may apply to the entrepreneur, for whom the loss of the business itself generates a negative emotional response while causing the loss of income, social status, and positive perceptions of self. For example, an entrepreneur must reorganize his life to cope without the business. It might be necessary to apply for jobs, join the unemployment line, and/or sell the house and move to a less expensive neighborhood (requiring the children to change schools). There might also be other stressors, such as responding to questions such as: “What do you do for a living?” or “How is your business going?” In addressing these secondary sources of...
stress, the entrepreneur is able to eventually reduce the negative emotions associated with thoughts of the events surrounding the loss of the business.

A Dual Process for Learning from Failure

Which process of recovery is most effective in promoting learning from the experience? It is not an "either/or" choice between the two orientations. Both loss-oriented and restoration-oriented coping styles are likely to have different costs. A loss-orientation involves confrontation, which is physically and mentally exhausting, whereas a restoration-orientation involves suppression, which requires mental effort and presents potentially adverse consequences for health. Oscillation between the two orientations enables an entrepreneur to obtain the benefits of each and to minimize the costs of maintaining one for too long—this dual process speeds the recovery process. Speeding the recovery process is important because it more quickly reduces the emotional interference with learning.

For example, starting with a loss-orientation provides an individual the ability to first focus on aspects of the loss experience and begin processing information about the business loss as well as breaking the emotional bonds to the failed business or project. When the entrepreneur's attention begins to shift from the event to aspects of the emotions itself, then learning is likely reduced by emotional interference and the entrepreneur should switch to a restoration-orientation. Switching to a restoration-orientation encourages individuals to think about other aspects of their life. It also breaks the cycle of continually thinking about the symptoms arising from the failure; such thoughts can increase negative feelings.

This restoration-orientation also provides the opportunity to address secondary causes of stress, which may reduce the emotional significance of the failure. When information processing capacity is no longer focused on the symptoms, the entrepreneur can shift back to a loss-orientation and use his or her information processing capacity to generate further meaning from the loss experience and also further reduce the emotional significance of the loss of the business. Oscillation should continue until the entrepreneur has emotionally recovered and been able to fully learn from the experience.

The dual process of learning from failure has a number of practical implications. First, knowledge that the feelings and reactions being experienced by the entrepreneur are normal for someone dealing with such a loss may help to reduce feelings of shame and embarrassment. This in turn might encourage the entrepreneur to articulate her feelings, possibly speeding the recovery process. Second, there are psychological and physiological outcomes caused by the feelings of loss. Realizing that these are "symptoms" can reduce secondary sources of stress and may also assist with the choice of treatment. Third, there is a process of recovery to learn from failure, which offers entrepreneurs some comfort that their current feelings of loss, sadness, and helplessness will eventually diminish. Fourth, the recovery and learning process can be enhanced by some degree of oscillation between a loss- and a restoration-orientation. Finally, recovery from loss offers an opportunity to increase one's knowledge of entrepreneurship. This provides benefits to the individual and to society.

ETHICS AND SOCIAL RESPONSIBILITY OF ENTREPRENEURS

The life of the entrepreneur is not easy. An entrepreneur must take risks with his or her own capital to sell and deliver products and services while expending greater energy than the average businessperson to innovate. In the face of daily stressful situations and other difficulties, the possibility exists that the entrepreneur will establish a balance between ethical...
exigencies, economic expediency, and social responsibility, a balance that differs from the point where the general business manager takes his or her moral stance.

A manager’s attitudes concerning corporate responsibility are related to the organizational climate perceived to be supportive of laws and professional codes of ethics. On the other hand, entrepreneurs with a relatively new company who have few role models usually develop an internal ethical code. Entrepreneurs tend to depend on their own personal value systems much more than other managers when determining ethically appropriate courses of action.

Although drawing more on their own value system, entrepreneurs have been shown to be particularly sensitive to peer pressure and general social norms in the community, as well as pressures from their competitors. The differences between entrepreneurs in different types of communities and in different countries reflect, to some extent, the general norms and values of the communities and countries involved. This is clearly the case for metropolitan as opposed to nonmetropolitan locations within a single country. Internationally, there is evidence to this effect about managers in general. U.S. managers seem to have more individualistic and less communitarian values than their German and Austrian counterparts.

The significant increase in the number of internationally oriented businesses has impacted the increased interest in the similarities and differences in business attitudes and practices in different countries. This area has been explored to some extent within the context of culture and is now beginning to be explored within the more individualized concept of ethics. The concepts of culture and ethics are somewhat related. Whereas ethics refers to the “study of whatever is right and good for humans,” business ethics concerns itself with the investigation of business practices in light of human values. Ethics is the broad field of study exploring the general nature of morals and the specific moral choices to be made by the individual in his or her relationship with others.

A central question in business ethics is, “For whose benefit and at whose expense should the firm be managed?” In addressing this question we focus on the means of ensuring that resources are deployed fairly between the firm and its stakeholders—the people who have vested interest in the firm, including employees, customers, suppliers, and society itself. If resource deployment is not fair, then the firm is exploiting a stakeholder.

Entrepreneurship can play a role in the fair deployment of resources to alleviate the exploitation of certain stakeholders. Most of us can think of examples of firms that have benefited financially because their managers have exploited certain stakeholders—receiving more value from them than they supply in return. This exploitation of a stakeholder group can represent an opportunity for an entrepreneur to more fairly and efficiently re-deploy the resources of the exploited stakeholder. Simply stated, where current prices do not reflect the value of a stakeholder’s resources, an entrepreneur who discovers the discrepancy can enter the market to capture profit. In this way the entrepreneurial process acts as a mechanism to ensure a fair and efficient system for redeploying the resources of a “victimized” stakeholder to a use where value supplied and received is equilibrated.

Therefore, while there is evidence that some use the entrepreneurial process to exploit others for profit, it is important to understand that the entrepreneurial process can be an important means of helping exploited stakeholders and at the same time setting up a viable business. Think of the entrepreneurial process as a tool that can be used effectively to achieve outcomes for the benefit of others (and the entrepreneur) rather than to the detriment of others. Some aspects of business ethics are indicated in the Ethics box in each chapter. Ethics is not only a general topic for conversation but also a deep concern of businesspeople.
ETHICS

COMPANY'S CODE OF ETHICS

The financial scandals of 2002 (and 2008) have already led to increased action by legislators and associations, and many companies are beginning to develop a code of ethics for all employees.

There are a number of advantages to implementing a code of ethics. The more your employees are aware of proper conduct, the more likely they are to do the right thing. They will better understand their responsibilities and expectations and assume the appropriate level of accountability when identifying and managing business risks. A code of ethics is more than just a formal document outlining related policies. It's about integrating positive values throughout an organization. Here are some key components to an effective program:

Leaders Set the Example: Employees often model their own behavior after executives, managers, and others who've succeeded in the company. Therefore, everyone at every level must adhere to the firm's guidelines. Discussing confidential financial information with a colleague, for instance, can have a ripple effect throughout all staff. If the members of senior management do not follow the highest ethical standards at all times, they should not be surprised when those who report to them fail to do so.

Ethics Is a Core Value: Companies known for their ethical business practices make ethics a key element of their corporate culture. Conducting yourself with integrity is considered as important as bottom-line results. Ethical standards are applied any time a decision is made or an action is taken, not just during adversarial situations. A recent survey by our company found that more organizations are taking ethics into account when hiring employees. Fifty-eight percent of chief financial officers polled said the qualities that impress them most about applicants, aside from ability and willingness to do the job, are honesty and integrity. That's a substantial increase from only 32 percent in 1997.

Employees Feel Safe to Share Concerns: The work environment must be one in which people feel they can deliver bad news to management without fear of repercussions. In an ethics-driven company, staff members can report any type of wrongdoing—whether it is false information on an expense report or major financial fraud—and feel confident they will not suffer negative career consequences. Once supervisors are made aware of a potential problem, they need to take immediate action. Failure to follow through on even minor issues can undermine the success of an ethics program.

Having a code of ethics will not prevent every crisis, but it will ensure that staff members have a clear understanding of the rules and make sure everyone is aware of the requirements. Then take steps to instill core values throughout the organization. With regular reinforcement, ethics will guide every decision your team makes and become a central element in the way your company conducts business.

Source: From Max Messmer, “Does Your Company Have a Code of Ethics?” Strategic Finance, April 2003. Excerpted with permission from Strategic Finance published by the Institute of Management Accountants, Montvale, NJ. For more information about reprints from Strategic Finance, contact PARS International Corp. at 212/221-6985.

ROLE OF ENTREPRENEURSHIP IN ECONOMIC DEVELOPMENT

The role of entrepreneurship in economic development involves more than just increasing per capita output and income; it involves initiating and constituting change in the structure of business and society. This change is accompanied by growth and increased output, which allows more wealth to be divided by the various participants. What in an area facilitates the needed change and development? One theory of economic growth depicts innovation as the key, not only in developing new products (or services) for the market but also in stimulating investment interest in the new ventures being created. This new investment works on both the demand and the supply sides of the growth equation; the new capital created expands the capacity for growth (supply side), and the resultant new spending utilizes...
The new capacity and output (demand side). This is reflected in the **product-evolution process**; a process through which innovation is developed and commercialized through entrepreneurial activity, which in turn stimulates economic growth.

The product-evolution process, illustrated in Figure 1.1 as a cornucopia, the traditional symbol of abundance, begins with knowledge in the base technology and science—such as

![Figure 1.1 Product Evolution](image)

**Figure 1.1 Product Evolution**

I  Recognition of social need
II  Initiation of technological innovation
III  Iterative synthesis leading to invention (pressing toward invention)
IV  Development phase
V  Industrial phase

- Science
- Thermodynamics
- Fluid mechanics
- Electronics
- Technology
The critical point in the product-evolution process is the intersection of knowledge and a recognized social need, which begins the product development phase. This point, called iterative synthesis, often fails to evolve into a marketable innovation and is where the entrepreneur needs to concentrate his or her efforts. The lack of expertise in this area—matching the technology with the appropriate market and making the needed adjustments—is an underlying problem in any technology transfer.

The innovation can, of course, be of varying degrees of uniqueness. Most innovations introduced to the market are ordinary innovations, that is, with little uniqueness or technology. As expected, there are fewer technological innovations and breakthrough innovations, with the number of actual innovations decreasing as the technology involved increases. Regardless of its level of uniqueness or technology, each innovation (particularly the latter two types) evolves into and develops toward commercialization and generates economic wealth.

Entrepreneurship has assisted in revitalizing areas of the inner city. Individuals in inner-city areas can relate to the concept and see it as a possibility for changing their present situation. One model project in New York City changed a depressed area into one that now has many small entrepreneurial companies.

**In Review**

**Summary**

The definition of an entrepreneur has evolved over time as the world's economic structure has changed and become more complex. In this text, entrepreneurship is defined as the process of creating something new with value by devoting the necessary time and effort; assuming the accompanying financial, psychological, and social risks and uncertainties; and receiving the resultant rewards of monetary and personal satisfaction and independence.

The entrepreneur then goes through the entrepreneurial process, which involves finding, evaluating, and developing opportunities for creating a new venture. Each step is essential to the eventual success of the new venture and is closely related to the other steps. There are both formal and informal mechanisms for identifying business opportunities. Although formal mechanisms are generally found within a more established company, most entrepreneurs use informal sources for their ideas, such as being sensitive to the complaints and chance comments of friends and associates. Once the opportunity is identified, the evaluation process begins. Basic to the screening process is understanding the factors that create the opportunity: technology, market changes, competition, or changes in government regulations. From this base, the market size and time dimension associated with the idea can be estimated. It is important that the idea fit the personal skills and goals of the entrepreneur, and that the entrepreneur have a strong desire to see the opportunity brought to fruition. In the process of evaluating an opportunity, the required resources should be clearly defined and obtained at the lowest possible cost.
This process requires that the individual and the firm have an entrepreneurial mind-set. We started our discussion of this mind-set with the concept of effectuation, which challenges traditional notions of the way that entrepreneurs think about their tasks. Although entrepreneurs think about some tasks in a causal way, they also are likely to think about some tasks effectually (and some entrepreneurs more so than other entrepreneurs). Rather than starting with the desired outcome in mind and then focusing on the means to achieving that outcome, entrepreneurs sometimes approach tasks by looking at what they have—their means—and selecting among possible outcomes. Who is to say whether the “causal chef” that starts with a menu or the “effectual chef” that starts with what is in the cupboard produces the best meal? But we can say that some expert entrepreneurs think effectually about opportunities.

Thinking effectually helps entrepreneurs make decisions in uncertain environments. When dealing with uncertainty, entrepreneurs must remain flexible in the way that they think and in their actions. In this chapter we introduced the notion of cognitive flexibility and emphasized that it is something that can be measured and learned. By asking questions related to comprehension, connection, strategy, and reflection, entrepreneurs can maintain an awareness of their thought process and in doing so develop greater cognitive adaptability.

Despite the way that he or she thinks (causally or effectually) and despite being cognitively flexible, an entrepreneur’s firm or project may still fail. Failure represents an opportunity to learn, but that learning is typically not automatic or instantaneous. Rather, learning from failure is difficult because failure causes a major loss to the entrepreneur. Most are likely to feel bad, which interferes with the learning process. Entrepreneurs who are able to recover from their negative emotional reaction to the loss more quickly will be in a better position to learn from the experience. The good news is that there is something that entrepreneurs can do to enhance their recovery and learning process. By using a dual process that oscillates between a loss- and a restoration-orientation, entrepreneurs can maximize their processing of information and minimize the emotional interference to that process. Obviously, the feelings associated with failure are more complicated than we have presented here, but there are benefits to be gained in simply knowing that it is natural to feel bad when something important is lost, that most people recover, and that there is a process that can enhance that recovery.

The study of entrepreneurship has relevance today, not only because it helps entrepreneurs better fulfill their personal needs but because of the economic contribution of the new ventures. More than increasing national income by creating new jobs, entrepreneurship acts as a positive force in economic growth by serving as the bridge between innovation and the marketplace. The study of entrepreneurship and the education of potential entrepreneurs are essential parts of any attempt to strengthen this link so essential to a country’s economic well-being.

**RESEARCH TASKS**

1. Speak to people from five different countries and ask what entrepreneurship means to them and how their national culture helps and/or hinders entrepreneurship.
2. Ask an entrepreneur about his business today and ask him to describe the decisions and series of events that led the business from start-up to its current form. Would you classify this process as causal, effectual, or both?
3. Ask two entrepreneurs and five students (not in this class) to fill out Mike Haynie’s “Measure of Adaptive Cognition” (see Table 1.2). How do you rate relative to the entrepreneurs? Relative to your fellow students?
4. When conducting a homework exercise for another class (especially a case analysis), ask yourself compression questions, connection questions, strategy questions, and reflection questions. What impact did this have on the outcome of the task?
5. What impact does entrepreneurship have on your local, state (or province), and national economies? Use data to back up your arguments.

CLASS DISCUSSION

1. List the content that you believe is necessary for an entrepreneurship course. Be prepared to justify your answer.
2. Do you really think that entrepreneurs think effectually? What about yourself—do you sometimes think effectually? In what ways is it good? Then why are we taught in business classes to always think causally? Are there particular problems or tasks in which thinking causally is likely to be superior to effectuation? When might effectuation be superior to causal thinking?
3. To be cognitively flexible seems to require that the entrepreneur continually question himself or herself. Doesn’t that create doubt that can be seen by employees and financiers such that success actually becomes more difficult to achieve? Besides, although flexibility is a good thing, if the firm keeps changing based on minor changes in the environment, the buyers are going to become confused about the nature of the firm. Is adaptation always a good thing?
4. Do you believe that ethics and social responsibility should be part of an entrepreneurship course or did the textbook authors just include a section on it to be “politically correct”?
5. What is the role of government in entrepreneurship? To what extent should it help protect people from entrepreneurship? Should it simply get out of the way and leave the market to reward or punish inappropriate behavior? Given your answers to these questions, what specific steps should the government take or what steps has it taken that should be reversed?
6. What excites you about being an entrepreneur? What are your major concerns?

SELECTED READINGS


In this conceptual article, the author presents information on a study that examined the possible differences in the thinking of entrepreneurs and other people. This paper offers a number of implications of a cognitive perspective for entrepreneurship research.

In this article the authors explore the differences in the decision-making processes between entrepreneurs and managers in large organizations. In particular they focus on a number of biases, such as the overconfidence bias, but also point out some benefits from the use of biases and heuristics.


The authors describe a model of entrepreneurial alertness and propose a research agenda for understanding opportunity identification. They investigate the origin of the entrepreneurial alertness concept and the notion of the psychological schema of alertness.


Economic development depends on the allocation of entrepreneurial resources to efforts to discover new profit opportunities. Limited entrepreneurial attention is allocated between maintaining current activities and starting new activities. The problem of allocating limited entrepreneurial attention in a variety of contexts is addressed.


The article reviews and synthesizes the findings of 21 empirical studies that examine the association between national cultural characteristics and aggregate measures of entrepreneurship, individual characteristics of entrepreneurs, and aspects of corporate entrepreneurship.


The article cites the importance of building strategic flexibility and a competitive advantage for organizations to survive in the face of emerging technical revolution and increasing globalization. The nature of the forces in the new competitive landscape requires a continuous rethinking of current strategic actions, organization structure, communication systems, corporate culture, asset deployment, and investment strategies—in short, every aspect of a firm’s operation and long-term health.


In this article the authors acknowledge that effective strategic leadership practices can help firms enhance performance while competing in turbulent and unpredictable environments. They then describe six components of effective strategic leadership. When the activities called for by these components are completed successfully, the firm’s strategic leadership practices can become a source of competitive advantage. In turn, use of this advantage can contribute significantly to achieving strategic competitiveness and earning above-average returns in the next century.


This study uses a cognitive approach to examine opportunity evaluation, as the perception of opportunity is essentially a cognitive phenomenon. The authors present
a model that consists of four independent variables (overconfidence, belief in the law of small numbers, planning fallacy, and illusion of control), a mediating variable (risk perception), two control variables (demographics and risk propensity), and the dependent variable (opportunity evaluation). They find that illusion of control and belief in the law of small numbers are related to how entrepreneurs evaluate opportunities. Their results also indicate that risk perception mediates opportunity evaluation.


Although failure in entrepreneurship is pervasive, theory often reflects an equally pervasive antifailure bias. Here, the author uses real options reasoning to develop a more balanced perspective of the role of entrepreneurial failure in wealth creation, which emphasizes managing uncertainty by pursuing high-variance outcomes but investing only if conditions are favorable. This can increase profit potential while containing costs. The author also offers propositions that suggest how gains from entrepreneurship may be maximized and losses mitigated.


In this book the authors provide tips on how to achieve an entrepreneurial mindset. For example, they discuss the need to focus beyond incremental improvements to entrepreneurial actions, assess a business’s current performance to establish the entrepreneurial framework, and formulate challenging goals by using the components of the entrepreneurial framework.


By considering the amount of uncertainty perceived and the willingness to bear uncertainty concomitantly, the authors provide a conceptual model of entrepreneurial action that allows for examination of entrepreneurial action at the individual level of analysis while remaining consistent with a rich legacy of system-level theories of the entrepreneur. This model not only exposes limitations of existing theories of entrepreneurial action but also contributes to a deeper understanding of important conceptual issues, such as the nature of opportunity and the potential for philosophical reconciliation among entrepreneurship scholars.


In this article the authors reexamine “the people side of entrepreneurship” by summarizing the state of play within the entrepreneurial cognition research stream, and by integrating the five articles accepted for publication in a special issue focusing on this ongoing narrative. The authors propose that the constructs, variables, and proposed relationships under development within the cognitive perspective offer research concepts and techniques that are well suited to the analysis of problems that require better explanations of the distinctly human contributions to entrepreneurship.

In this article, the author argues that an explanation for the creation of artifacts such as firms/organizations and markets requires the notion of effectuation. Causation rests on a logic of prediction, effectuation on the logic of control. The author illustrates effectuation through business examples and realistic thought experiments, examines its connections with existing theories and empirical evidence, and offers a list of testable propositions for future empirical work.


Sarasvathy Saras. www.effectuation.org. This Web site provides an up-to-date collection of works on effectuation.


In this paper the author uses the psychological literature on grief to explore the emotion of business failure, suggesting that the loss of a business from failure can cause the self-employed to feel grief—a negative emotional response that interferes with the ability to learn from the events surrounding that loss. The author discusses how a dual process of grief recovery maximizes the learning from business failure.


In this article the author offers suggested changes to pedagogy to help students manage the emotions of learning from failure and discusses some of the challenges associated with measuring the implications of these proposed changes. The author then expands his scope to explore the possibility of educating students on how to manage their emotions to avoid failure and, more generally, improve their emotional intelligence, and how organizations can improve their ability to help individuals regulate their emotions.


In this article the author develops a multi- and meso-level theory of grief recovery time from the loss of a family business. The multi-level aspect of the model suggests how primarily micro theories of grief and sense making can help explain grief recovery time at the family group level. The meso-level aspect of the model provides insight into recovery from the loss of a family business by proposing how grief dynamics interact at the individual level through emotional intelligence and the family group level through emotional capability. By supplementing theories of grief with those of sense making, the model provides a deeper understanding of the grief recovery process. This model has implications for scholars and practical implications for family business members and the family unit.


As the author states: Face it. Everyone fails, at least sometimes. Especially nowadays. It’s what you do next that makes all the difference. That’s where this book comes in. This book helps you learn all you can from your failure, instead of letting it defeat you. You’ll discover proven techniques for managing the emotional trauma of failure . . . objectively understanding what actually happened . . . and applying those lessons quickly and effectively, so you can transform yesterday’s failure into tomorrow’s triumph!
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END NOTES

8. A version of this process can be found in Howard H. Stevenson, Michael J. Roberts, and H. Irving Groubeck, New Business Ventures and the Entrepreneur (Burr Ridge, IL: Richard D. Irwin, 1985), pp. 16–23.


28. Interviews with employees of organizations that have died reveal negative emotions such as those associated with grief. See S. G. Harris, and R. I. Sutton, “Functions of Parting Ceremonies in Dying Organizations,” Academy of Management Journal 29 (1986), pp. 5–30.


32. Stroebe and Schut, “The Dual Process of Coping.”


34. For summary of the research on ethics in entrepreneurship, see the papers published as part of the Ruffin Lecture Series of 2002 by the Business Ethics Society of The Darden School, University of Virginia.
