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Dear JBE Readership:

Welcome to the fall 2014 issue of the Journal of Business and Entrepreneurship. We are truly excited about the ever increasing quality of submissions. We hope that you will enjoy the diverse topics being addressed in this issue.

We hope that you have enjoyed the special issue on entrepreneurial education from the Entrepreneurial Education Project (EEP) recently released as our first ever special issue and tentatively an annual relationship JBE will have with this group. We are also working diligently to have the journal listed in two international ranking systems—stay tuned. If you are not currently a subscriber, please join the Association for Small Business and Entrepreneurship www.asbe.us.

I would also like to encourage every subscriber to contact their university library and ensure that they have a subscription for the journal.

William T. Jackson (Bill)  Mary Jo Jackson  Daniel James Scott
Managing Editor  Editor  Associate Editor
LEGITIMATION OF CLEANTECH COMPANIES:
VENTURE CAPITAL FINANCING AND FEDERAL GOVERNMENT FUNDING

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ABSTRACT

We studied 56 venture-capital-backed companies that received financial support from the U.S. Department of Energy. We argued that those companies derived their legitimacy with the DOE in large part from their lobbying in Washington and from their venture capital firms. We reasoned that the greater their legitimacy from the viewpoint of the DOE, the more federal funding they received. We found that the amount of federal funding correlated with the amount of venture capital and with the amount spent on lobbying, but not with the reputation of their venture capital firms. Companies received, on average, one dollar of federal funding for each dollar of venture capital.

INTRODUCTION

The U.S. Department of Energy provides one-half of the financing of young venture-capital-backed cleantech companies on average. It raises the question, what gives those companies legitimacy in the eyes of federal agencies evaluating their proposals for federal funds? When young venture-capital-backed cleantech companies seek federal funding they lack the legitimacy (Stinchcombe, 1965) that comes from years of operating successfully. Such companies have few or no customers, little or no revenue, operating losses, and negative operating cash flow. We propose three principal sources of their legitimacy: their venture capital; their venture capitalist’s reputation (Marcus et al., 2013); and their lobbying expenditures.
Venture Capital Investment In Cleantech

According to Patel (2006), “Cleantech is a venture capital buzzword, making eyes sparkle the way ‘biotech’ and ‘infotech’ [and nanotech] once did.” Cooke (2008) commented that while Patel’s description is not a definition, it is probably an accurate characterization of cultural origins of this “particular technology species.” Cooke also observed that venture capitalists’ classification of cleantech is so indiscriminate and broad that it could conceivably encompass “dirtytech.” Burtis, Epstein, and Huang’s (2004) list of cleantech segments, for instance, covers a spectrum so wide that it accommodates items as mundane as consumer products like non-toxic household cleaners and biodegradable eating utensils to extraordinary advanced technologies such as nano-material for more efficient and fungible solar photovoltaic panels.

The annual total amount of venture capital invested in U.S. cleantech companies and the number of deals from the beginning of 1995 through to the end of 2012 are shown in Figure 1. The first peak, which occurred in 2000, coincided with the frenzy of venture capital investment during the Internet bubble. The rapid rise in cleantech venture capital investment began in 2005, peaked in 2008, dropped in 2009 in the aftermath of the banking industry meltdown, and recovered in 2010, one year after the 2009 peak in federal cleantech expenditure. At its peak in 2011, it accounted for 15.6% of all venture capital investment.

![Cleantech: Venture Capital Investments](image-url)
Total cleantech investment by all venture capital firms fell 28% in 2012; a decline that accelerated in 2013 when investment for the first nine months was down 60% from the previous year; it was the lowest level since 2005. The decline in investment is due to the dismal venture capital returns from cleantech. Lange et al. (2011) found the returns of 52 venture-capital-backed companies that had IPOs between 2000 and 2010 were not satisfactory. The median IRR for the first round of venture capital was 26.1% with a range from -10.4% to 140.0%. The median IRR on the third round was 24.5% with a range from 8.1% to 184.6%. Those median returns fell way short of the 80% that venture capitalists expect for successful early-stage investments and the 40% for successful later stage ones. To put it in perspective, the median venture capital return on first-round investments in Internet companies was 506.9%; in software companies 124.8%; and computer hardware companies 148.9% (Bygrave and Zacharakis, 2014). A median annual return of around 25% on cleantech IPOs is not high enough to sustain venture capital investment at 2008-2011 levels.

Kleiner Perkins Caufield & Byers is the most successful venture capital firm in the history of the industry, and generally regarded as a trendsetter that is followed both inside and outside the venture capital industry. It was the leading investor in cleantech. But its reputation has been tarnished by the poor returns on its cleantech portfolio (McBride and Groom, 2013). As a result it has cut back its cleantech activity.

**Federal Support For Cleantech**

The U.S. federal government has at least 92 different programs supporting cleantech (Jenkins et al., 2012). Cumulative cleantech spending on all federal programs in the period 2002-2008 was $51 billion; annual spending peaked at $44.3 billion in 2009 because of an enormous boost from the American Recovery and Reinvestment Act of 2009 (ARRA)—better known as the stimulus package—which amounted to $25 billion or 56.4% of the total. From that peak of $44.3 billion, the amount of federal spending declined sharply to $16.1 billion in 2012, and according to Jenkins et al. (2012) is projected to fall to $11.0 billion in 2014.

Federal cleantech programs fall into three general categories: direct spending such as grants; tax expenditures, which are mainly tax credits; and loan
programs, which are loans and loan guarantees. Total federal expenditure, actual and projected, on cleantech from 2009 through 2014 comprises $89.1 billion of direct support, $51.4 billion of tax expenditures, and $10.3 billion of loan guarantees. The loan program expenditure, $10.3 billion, is only the amount of federal money that is budgeted to cover anticipated losses on federally guaranteed loans, which are estimated to total $49.7 billion. Actual and projected federal support for cleantech from 2009 through 2014 is $190.2 billion when all federally guaranteed loans are included rather than only anticipated losses.

Venture Capital Leveraged With Federal Funding

The classic venture capital business model has not worked satisfactorily for cleantech companies (Lange et al., 2013), which are far more capital intensive than venture capital portfolio companies in industries such as software and the Internet where the venture capital model works so well. What’s more, cleantech stocks have failed to excite public investors, who are crucial in sustaining a viable IPO market; this has made it difficult to raise substantial capital with IPOs (Petkova et al., 2011), which in turn has meant that venture capitalists have had to dig deeper into their pockets just to keep their cleantech companies viable. In an era when it seems that everyone in distress turns to the government for a bailout, it’s no surprise that most venture-capital-backed cleantech companies have become dependent on the federal government as a major source of capital, which supplements and in some instances surpasses their equity capital. In the results section of this paper we report that on average a cleantech company’s federal funding equaled 99.5% (range: 0.75% - 520%) of its venture capital. Put another way, the mean federal funding-to-venture capital ratio was 0.995. That ratio is analogous to the debt-to-equity ratio, which measures a company’s financial leverage.

Until cleantech came along, venture capitalists’ portfolios did not contain many companies that were dependent on direct federal funding. (Granted, many portfolio companies benefited indirectly from federal spending; for example, there would be no biotech industry but for massive government support for R&D in university and government labs). Today, direct federal funding has become crucially important in the venture capitalists’ business model for financing cleantech companies. Many cleantech companies would not survive without it; and as it has turned out, some have failed even though they had enormous federal
support (e.g., A123, Fisker, and Solyndra). If federal financial support drops as precipitously as projected by Jenkins et al. (2012), it is inevitable that venture capital investment in cleantech will shrink.

The lavish government support for venture-capital-backed cleantech companies at a time when venture capital investment in cleantech was at record heights is contrary to the prescription of Lerner and Gompers (1999) who recommended that direct government support should focus on technologies that are not currently popular with venture capitalists.

**Lobbying By Portfolio Companies And Venture Capital Firms**

With so much at stake, venture capital firms’ portfolio companies dramatically stepped up their lobbying in Washington simultaneously with the enactment of American Recovery and Reinvestment Act, which was signed into law by President Obama on February 17, 2009. Half of the venture-capital-backed cleantech companies in our data set hired lobbyists. And venture capital firms themselves increased their lobbying on cleantech issues and their contributions to political campaigns. The U.S. venture capital industry spent only $265,000 per year on lobbying during its glory days of 1998-2000 when it boomed as never before or since; in contrast the average annual spending was $6.662 million in 2010-2012, when the industry was in the doldrums. It is even more noteworthy that spending peaked at $8.16 million in 2009 when cleantech companies were scrambling to get funding from the stimulus package. What’s more, spending in 2009 jumped up 56% from the previous year. It is circumstantial evidence that cleantech was probably the main reason for the sudden boost in lobbying by both portfolio companies and venture capital firms in 2009.

**HYPOTHESES**

Early-stage companies in high-tech industries such as some cleantech segments face a daunting challenge when trying to raise resources because their principal assets are intangible and knowledge-based. Many search for venture capital, but relatively few find it (Bygrave & Zacharakis, 2014). For those successful few, venture capital has non-financial benefits, of which certification and value-added are preeminent. Certification (Megginson and Weiss, 1991; Hsu 2004) of the business model and management team comes from passing the
rigorous scrutiny of venture capitalists. And value-added (e.g., Timmons and Bygrave, 1986; Sapienza, 1992; Rosenstein et al., 1993) comes from the venture capitalist’s expertise and contacts, especially if the lead venture capital firm has a high reputation (Gompers, 1996) for investing in cleantech.

Studies of the effect of a venture capital firm’s reputation on the performance of a portfolio company have dealt almost entirely with IPO and post-IPO valuations (e.g., Chang, 2004; Dimov and Shepherd, 2005; Pollock et al., 2010; Krishnan and Masulis, 2012; Chou et al., 2013) presumably because valuation is a precise measure and data are readily available. Among the first to make the connection between the reputation (sometimes called prestige or prominence) of venture capital firms and the performance of their portfolio companies were Bygrave and Timmons (1992), who found that companies backed by top-20 venture capital firms generated returns at the IPO and post-IPO that were substantially superior to those produced by companies backed by non-top-20 firms. The relationship between a company’s post-IPO performance and the reputation of its venture capital firm was confirmed by Krishnan et al. (2011) in a comprehensive study of IPOs between 1993 and 2004. That finding was congruent with Nahata’s (2008) findings. However, Nahata found that not all measures of venture capital reputation, including cumulative aggregate investment and cumulative number of investment rounds, consistently predicted company performance. On the other hand, Lee et al. (2011) determined reputation with a compound measure comprising six items including the total number of portfolio firms a venture capital firm had invested in and the total dollar amount invested. They found that a venture capital firm’s reputation combined with its degree of specialization in a portfolio company’s industry segment determined the value added to a portfolio company.

Although there is an abundance of anecdotal accounts and normative advice for entrepreneurs about the non-financial value-added that comes with financial backing from a high reputation venture capital firm (e.g., Timmons and Bygrave, 1992), there is a paucity of research studies into the influence of a venture capital firm’s reputation on anything other than financial performance (e.g., Krishnan and Masulis’s 2012 review). Two exceptions are Baker and Gompers (2003) and Krishnan et al. (2011), who reported positive association between venture capital reputation and superior governance features in portfolio companies. Another exception is a study by Chemmanur et al. (2011) who looked at the effect of the reputation of venture capital firms on the efficiency (total factor productivity, TFP) of the companies in which they invested.
Apart from studies that use IPO and post-IPO performance to measure the ‘value of value-added,’ there is not much research based on objective quantitative outcomes measured with ratio scales. Most non-IPO-based value-added studies have employed qualitative measures and/or retrospective subjective evaluations using interval or ordinal scales, according to Large and Muegge (2008), who, in their extensive review of 20 empirical value-added studies, found none that measured both inputs and outcomes with objective ratio scales and only two that used such scales to determine outcomes. Nevertheless, Large and Muegge (2008) concluded that there was widespread evidence for the existence of value-added and that its contribution was significant. Five studies in their survey explicitly supported the association between value-added and venture performance (MacMillan et al., 1989; Sapienza, 1992; Sweeting and Wong, 1997; Flynn and Forman, 2001; Dolvin, 2005). Also they found implicit support in twelve of the other fifteen studies by Timmons and Bygrave (1986), Perry (1988), Sahlman and Gorman (1989), Gomez-Meija (1990), Ehrlich et al. (1994), Fried and Hisrich (1995), Steier and Greenwood (1995), Murray (1996), Gabrielsson and Huse (2002), Kaplan and Stromberg (2003), Saetre (2003), Torres and Murray (2003), Busentitz et al. (2004), Knyphausen and Aufseß (2005), Maula et al. (2005).

Large and Muegge’s (2008) conclusion and subsequent research are an advance on Mason and Harrison’s (1999) comment that “whether and in what ways venture capitalists add value continues to be a lively focus for debate, with no consensus on the answers.” Even so, value-added continues to be a tantalizingly simple concept that in theory differentiates the performance of venture capital firms, but in practice is elusive and difficult to operationalize. For instance, a conundrum that has yet to be satisfactorily resolved is how to separate the effect of a venture capital firm’s initial selection of a portfolio company from its subsequent value-adding (e.g., Nahata, 2008). Chemmanur et al. (2011) made progress towards resolving it when they used ingenious analytical techniques to differentiate the effects of venture capital screening (selection) from post-investment monitoring. They demonstrated that a high reputation venture capital firm’s monitoring, more so than a low reputation firm’s monitoring, improved the efficiency (TFP) of private companies—what could also be regarded as evidence of value-added.

However, one of the authors of the present paper was on a panel with a leading U.S. venture capitalist who told the audience of more than 100 venture capitalists that he stopped believing in post-investment value-added after his firm
analyzed its portfolio and found that companies with which it spent the least time advising, mentoring, and counseling performed best and vice-versa. The venture capitalist concluded that most of the value-added came from the initial selection of a portfolio company. Fortunately, in deriving our hypotheses we do not need to specify whether the added-value came at the initial selection or subsequent to it.

A venture capital firm’s reputation is intimately tied to its value-adding capability. For example, Rosenstein et al. (1993) found that the top-20 venture capital firms added value, whereas the non-top-20 firms did not. Combining that with the finding of Lee et al. (2011) that a high reputation venture capital firm that specialized in investing in its portfolio company’s industry contributed the most value-added, we reason that high reputation firms specializing in cleantech investments enhance the legitimacy of their portfolio companies the most. We also reason that the more venture capital that a company has, the greater its legitimacy. And the greater the legitimacy of a company from the viewpoint of federal agencies from which it requests financial support (primarily grants, loans, and loan guarantees), the more federal funding it receives. It leads to the following hypotheses:

\[ H1: \text{The amount of federal funding awarded to a venture-capital-backed cleantech company increases with the amount of venture capital that the company has.} \]

\[ H2: \text{The higher the reputation of a company’s venture capitalists, the more federal funding it receives.} \]

Another way in which cleantech companies raise their legitimacy in the eyes of federal agencies is by lobbying. As we have already noted, there was a huge surge in lobbying expenditures by cleantech companies in 2009 as they scrambled for a share of the $110 billion of federal support that became available for cleantech initiatives over the period 2009-2011 (Jenkins, 2012). According to Stigler (1971), Shleifer and Vishny (1994), and Banerjee (1997), politically connected firms are more likely to receive federal funding. This was confirmed in a study of financial institutions that applied for government funding from the Troubled Asset Relief Program (TARP) in 2008-2009; it found a strong relationship between a financial institution’s political connections, including
lobbying expenditure, and its access to government funding (Duchin and Sosyura, 2012). This leads to our third hypothesis:

**H3:** The amount of federal funding received by a cleantech company increases with the amount it spends on lobbying.

**METHOD**

We tested H1, H2, and H3 on a set of 56 venture-capital-backed cleantech companies that received federal funding from the U.S. Department of Energy through 2012. Most, but not all, of the federal funding came as a result of the stimulus package, so we included an indicator variable to control for the years 2009-2011 when most of the stimulus package was disbursed and awards were plentiful and generous. We did not control for industry sector because the federal funding came exclusively from the Department of Energy, which meant that we were dealing with a subset of cleantech companies—ones involved with energy generation, storage, and alternative vehicles—rather than the gamut of companies under the cleantech rubric.

Federal funding was the combined amount of grants, loans, and loan guarantees awarded to a company. It was the amount awarded not the amount subsequently drawn down because we were examining what legitimation factors influenced the Department of Energy at the time when it was evaluating a request for funding. For example, Fisker Automotive was awarded a $528,700,000 loan in 2009 by the U.S. Department of Energy, but had drawn down ‘only’ $192,300,000 when the government froze the outstanding balance of $336,400,000 in 2011 because Fisker was in default of the loan agreement (Koetsier, 2013).

The amount of venture capital was the sum that a company had received before it applied for federal funding. In every case, a company already had venture capital before it applied for federal funding. The lobbying expenditure was the total amount that a company paid to Washington lobbyists. In all instances, lobbying expenditure preceded an award from the U.S. Department of Energy.

We measured the reputation of a venture capital firm by the number of cleantech investments that it had made. It gauges investment activity, which Lee et al. (2011) state is an important component of a VC’s reputation because it enhances the firm’s visibility, or prominence in its industry (Rindova et al.,
2007). While our measure is not incompatible with the measures of reputation used by Gulati and Higgins (2003) or Dimov et al. (2007), we think ours is more relevant for the present research because it determines the activity of a venture capital firm in only cleantech, whereas theirs measured activity in all industry sectors. After all, reputation is in the eyes of the beholder, in our case the Department of Energy administrators who evaluate proposals, so it seems reasonable to assume that they are much more interested in a venture capital firm’s investment activity in cleantech than—let’s say—social media.

The top-3 venture capital firms were Kleiner Perkins Caufield & Byers with 138 investments, Khosla with 109, and Draper Fisher Jurvetson with 96. The independent variable was the reputation of the venture capital firm with the most cleantech investments of all the firms that invested in a company; that is the highest reputation firm that had invested in a company before it applied to the Department of Energy for funding. We decided to use the reputation of only the firm with the highest reputation rather than the average reputation of all the firms invested in a company because we believe that is what someone familiar with cleantech venture capitalists—for example a Department of Energy administrator—would recognize, especially if it were a high reputation firm such as Kleiner Perkins Caufield & Byers, or perhaps would fail to recognize if it were a low reputation firm like, let’s say, Funk Ventures.

The frequency distribution of the venture capitalist’s reputation was extremely skewed and could not be manipulated into a normal one with mathematical transformations, so it was converted into an indicator variable with two categories: number of cleantech investments 0 to 39, D=0 (n=28); 40 to 138, D=1 (n=28). In this respect, we are consistent with Gompers (1996), who used an indicator variable to classify venture capitalist’s reputation.

Venture capital data were gathered from VentureXpert and i3; lobbying expenditures came from the Senate Office of Public Records via OpenSecrets.org; and federal funding data came from the U.S. Department of Energy.

We used OLS regression to test H1, H2, and H3. The dependent variable was the amount of federal funding. Here is the regression equation for testing H1, H2, and H3:

\[
\text{Amount of federal funding} = f(\text{Amount of venture capital}, \text{Lobbying expenditure}, \text{VC’s reputation}).
\]
The amount of venture capital serves a dual purpose in our regression models because it not only is a gauge of legitimacy, but it also serves as a proxy measure for the size of a company and in that capacity can be regarded as a control variable when testing H2 and H3.

The frequency distributions of the raw data for federal funding and amount of venture capital were very skewed so they were transformed to natural logarithms, which produced approximately normal distributions. Lobbying expenditure was bimodal: 28 companies had spent money on lobbying, and 28 had not; which was a fortuitous even split in the data set. Lobbying expenditures of the 28 companies that had spent money on lobbying ranged from $10,000 to $2,680,000 with a median of $395,000. We used a categorical variable for lobbying expenditure: $0 (n=28); >$0<$400,000 (n=14); ≥$400,000 (n=14).

We ran a regression on the complete data set (n=56). Dummy coding was used for the three lobbying expenditure categories with $0 as the control group. Then we ran a segmented regression on the set of 28 companies that had spent money on lobbyists; we used the natural logarithm of lobbying expenditure, which approximated to a normal distribution. We also ran a segmented regression on the 28 companies with no lobbying expenditure, but it was only a partial test of our equation because by definition it did not have a lobbying expenditure variable.

RESULTS & DISCUSSION

Descriptive Statistics

The 56 companies in the data set had a total of $4.04 billion of venture capital and were awarded $3.08 billion of federal funding by the U.S. Department of Energy (Figure 2); the mean amount of federal funding per company was $54.9 million (median $9 million, range $320,000 to $529 million). The mean amount of venture capital was $72.1 million (median $33.1 million, range $500,000 to $436 million). Lobbying expenditure totaled $12.9 million; mean per company was $229,581 (median $5,000; range $0 to $2.68 million). The average ratio of the amount of federal funding to the amount of venture capital per company was 0.995 (not shown in Figure 2); or put differently, companies on average leveraged one dollar of venture capital with one dollar of federal funding.
The 28 companies that lobbied had a total of $2.48 billion of venture capital and were awarded a total of $2.29 billion of federal funding (Figure 3). In contrast, the 28 companies that did not lobby had a total of $1.55 billion of venture capital and were awarded a total of $786 million of federal funding (figure not shown). Companies that lobbied had on average $88.7 million of venture capital and raised $81.8 million of federal funding; in contrast those that did not lobby had on average $55.5 million of venture capital and raised ‘only’ $28.1 million of federal funding. Thus it appears that lobbying paid off handsomely with companies that lobbied garnering almost three times as much federal funding on average as companies that did not lobby. However, companies that lobbied had the most venture capital, so before we came to any conclusions about whether or not the amount of federal funding was influenced by the amount of venture capital or the amount spent on lobbying or both we had to separate the two effects with regression analysis.

Figure 2. Descriptive statistics for all companies (n=56)

<table>
<thead>
<tr>
<th></th>
<th>All Companies (n=56)</th>
<th>Mean</th>
<th>Median</th>
<th>Stand. Deviation</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Sum</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Funding</td>
<td>$54,935,390</td>
<td>$9,000,000</td>
<td>$13,502,756</td>
<td>$320,000</td>
<td>$28,700,000</td>
<td>$3,076,381,815</td>
<td>56</td>
<td></td>
</tr>
<tr>
<td>Ln(Amt Federal Funding)</td>
<td>16.243</td>
<td>16.013</td>
<td>1.734</td>
<td>12.676</td>
<td>20.086</td>
<td>56</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amt Venture Capital</td>
<td>$72,112,694</td>
<td>$33,078,085</td>
<td>$96,008,891</td>
<td>$500,000</td>
<td>$436,200,000</td>
<td>$4,038,310,856</td>
<td>56</td>
<td></td>
</tr>
<tr>
<td>Ln(Amt Venture Capital)</td>
<td>17.151</td>
<td>17.313</td>
<td>1.615</td>
<td>13.122</td>
<td>19.894</td>
<td>56</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lobbying Expenditure</td>
<td>$229,851</td>
<td>$5,000</td>
<td>$425,209</td>
<td>50</td>
<td>$2,680,000</td>
<td>$12,871,631</td>
<td>56</td>
<td></td>
</tr>
<tr>
<td>Lobbying Expenditure ≤$400,000</td>
<td>0.25</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>14</td>
<td>56</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lobbying Expenditure &gt;$0&lt;$400,000</td>
<td>0.25</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>14</td>
<td>56</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lobbying Expenditure &gt;$0</td>
<td>0.5</td>
<td>0.5</td>
<td>0</td>
<td>1</td>
<td>28</td>
<td>56</td>
<td></td>
<td></td>
</tr>
<tr>
<td>First Federal Funding 2009-2011</td>
<td>0.73</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>41</td>
<td>56</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Venture Capitalist's Reputation</td>
<td>55.6</td>
<td>38</td>
<td>46.2</td>
<td>0</td>
<td>138</td>
<td>3111</td>
<td>56</td>
<td></td>
</tr>
<tr>
<td>Venture Capitalist's Reputation</td>
<td>0.48</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>28</td>
<td>56</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Figure 3. Descriptive statistics for companies with lobbying expenditures (n=28)

<table>
<thead>
<tr>
<th></th>
<th>Companies with lobbying expenditures, n=28</th>
<th>Mean</th>
<th>Median</th>
<th>Stand. Deviation</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Sum</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Funding</td>
<td>$81,782,957</td>
<td>$16,950,000</td>
<td>$142,499,528</td>
<td>$1,400,000</td>
<td>$28,700,000</td>
<td>$2,289,922,803</td>
<td>28</td>
<td></td>
</tr>
<tr>
<td>Amt Venture Capital</td>
<td>$88,703,342</td>
<td>$70,947,560</td>
<td>$94,139,601</td>
<td>$2,000,000</td>
<td>$436,200,000</td>
<td>$2,483,693,584</td>
<td>28</td>
<td></td>
</tr>
<tr>
<td>Ln(Amt Venture Capital)</td>
<td>17.656</td>
<td>18.073</td>
<td>1.360</td>
<td>14.509</td>
<td>19.894</td>
<td>28</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lobbying Expenditure</td>
<td>$459,701</td>
<td>$397,500</td>
<td>$508,651</td>
<td>$10,000</td>
<td>$2,680,000</td>
<td>$12,871,631</td>
<td>28</td>
<td></td>
</tr>
<tr>
<td>First Federal Funding 2009-2011</td>
<td>0.82</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>23</td>
<td>28</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Venture Capitalist's Reputation</td>
<td>52.0</td>
<td>28</td>
<td>51.5</td>
<td>0</td>
<td>138</td>
<td>1455</td>
<td>28</td>
<td></td>
</tr>
<tr>
<td>Venture Capitalist's Reputation</td>
<td>0.39</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>11</td>
<td>28</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Regression Analysis

The first OLS regression, Model I, for all 56 companies is shown in Figure 4. It shows that Ln(Amount Federal Funding) correlates positively with
Ln(Amount Venture Capital), \( p=0.00027 \), and with Lobbying Expenditure greater than $400,000, \( p=0.0105 \). Thus, H1 and H3 are accepted. Ln(Amount Federal Funding) is not correlated with Venture Capitalist’s Reputation; hence H2 is rejected. The control variable for the years of the stimulus package, 2009-2011, is significant, \( p=0.024 \). And the model is very significant, \( p<0.000001 \), with adjusted \( R^2 \) at a respectable 0.47.

### Figure 4. Regression Models

<table>
<thead>
<tr>
<th>Dependent Variable: Ln(Amount Federal Funding)</th>
<th>Coefficient</th>
<th>( p )-value</th>
<th>Coefficient</th>
<th>( p )-value</th>
<th>Coefficient</th>
<th>( p )-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td>7.42</td>
<td>0.00033</td>
<td>3.08</td>
<td>0.46</td>
<td>6.37</td>
<td>0.0049</td>
</tr>
<tr>
<td>Ln(Amount Venture Capital)</td>
<td>0.47</td>
<td>0.00027</td>
<td>0.25</td>
<td>0.34</td>
<td>0.54</td>
<td>0.00024</td>
</tr>
<tr>
<td>Lobbying Expenditure( \geq $400,000 )</td>
<td>1.21</td>
<td>0.0105</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Lobbying Expenditure( &gt;0&lt;$400,000 )</td>
<td>-0.24</td>
<td>0.57</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Ln(Lobbying Expenditure)</td>
<td>NA</td>
<td>NA</td>
<td>0.69</td>
<td>0.014</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Venture Capitalist’s Reputation</td>
<td>-0.29</td>
<td>0.41</td>
<td>0.41</td>
<td>0.53</td>
<td>-0.60</td>
<td>0.16</td>
</tr>
<tr>
<td>First Federal Funding in 2009-2011</td>
<td>0.94</td>
<td>0.024</td>
<td>0.67</td>
<td>0.38</td>
<td>0.93</td>
<td>0.046</td>
</tr>
</tbody>
</table>

Number of Observations | 56 | 28 | 28
Adjusted \( R^2 \) | 0.47 | 0.29 | 0.51

- \( F = 10.78 \)
- Significance \( F = 4.57E-07 \)

### Figure 5. Pearson correlation matrix with all companies (n=56)

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Ln(Amt Federal Funding)</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Ln(Amt Venture Capital)</td>
<td>0.60***</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Lobbying Expenditure( \geq $400,000 )</td>
<td>0.50***</td>
<td>0.34*</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Lobbying Expenditure( &gt;0&lt;$400,000 )</td>
<td>-0.11</td>
<td>0.029</td>
<td>-0.33*</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Venture Capitalist’s Reputation</td>
<td>-0.071</td>
<td>0.11</td>
<td>-0.14</td>
<td>-0.062</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>6. First Federal Funding in 2009-2011</td>
<td>0.38**</td>
<td>0.29*</td>
<td>0.07</td>
<td>0.16</td>
<td>0.019</td>
<td>1</td>
</tr>
</tbody>
</table>

* \( p<0.05 \); ** \( p<0.01 \); *** \( p<0.001 \)

The regression model for the 28 companies that lobbied, Model II in Figure 4, shows that the Ln(Amount Federal Funding) correlates with Ln(Lobbying Expenditure), \( p=0.014 \), but not with Ln(Amount Venture Capital) nor with Venture Capitalist’s Reputation. Thus, H3 is supported, but H1 and H2 are not. The model is significant, \( p=0.018 \), and adjusted \( R^2 \) is 0.29. We also ran a regression on the 28 companies that did not lobby, Model III in Figure 4. As we mentioned earlier, there was no variable for Lobbying Expenditure because companies in this set did not lobby. Ln(Amount Federal Funding) correlates
with Ln(Amount Venture Capital), \( p=0.00024 \), but not with Venture Capitalist’s Reputation. Thus H1 is accepted and H2 is rejected. The model is significant, \( p=0.00014 \), and adjusted R\(^2\) is 0.51.

**Figure 6. Pearson correlation matrix with companies that lobbied (n=28)**

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Ln(Amount Federal Funding)</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Ln(Amount Venture Capital)</td>
<td>0.44*</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. ln(Lobbying Expenditure)</td>
<td>0.53*</td>
<td>0.34</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Venture Capitalist’s Reputation</td>
<td>0.15</td>
<td>0.37</td>
<td>-0.14</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>5. First Federal Funding in 2009-2011</td>
<td>0.22</td>
<td>0.24</td>
<td>0.01</td>
<td>0.18</td>
<td>1</td>
</tr>
</tbody>
</table>

* \( p<0.05 \)

**Summary of The Hypotheses Tests**

The summary of the results of the hypotheses tests, Figure 7, shows that the amount of venture capital correlated with the amount of federal funding in Models I and III, but not Model II. In the case of Model II, which is for the companies that lobbied, the amount spent on lobbying was the only significant factor that influenced the amount of federal funding.

The amount spent on lobbying affected the amount of federal funding (Models I and II). But Model I contains a nuance that shows a statistically significant difference between the group of 14 companies that spent more than $400,000 on lobbying and the control group of 28 companies that spent nothing, but no significant difference between 14 companies that spent from $10,000 to $400,000 on lobbying and the control group. Thus, lobbying paid off best for companies that spent the most on lobbying; a conclusion that was reinforced by Model II.

**Figure 7. Summary of hypotheses tests**

<table>
<thead>
<tr>
<th>Amount of Federal Funding correlates with the following:</th>
<th>Model I</th>
<th>Model II</th>
<th>Model III</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount of Venture Capital</td>
<td>H1</td>
<td>Accept***</td>
<td>Reject</td>
</tr>
<tr>
<td>Venture Capitalist’s Reputation</td>
<td>H2</td>
<td>Reject</td>
<td>Reject</td>
</tr>
<tr>
<td>Lobbying Expenditure</td>
<td>H3</td>
<td>Accept*</td>
<td>Accept*</td>
</tr>
</tbody>
</table>

* \( p<0.05 \); *** \( p<0.001 \)
Venture capitalist’s reputation did not correlate with the amount of federal funding in any of the three models. Hence, it appears that a venture capital firm’s reputation brought no direct value-added when it came to raising money from the U.S. Department of Energy. Why doesn’t the empirical data support our hypothesis that companies with ‘higher reputation’ venture capitalists get more federal funding? We think that a plausible explanation is that venture capital firms with the most companies in their portfolios have the least time to lobby on behalf of individual companies; instead, the companies have to do their own lobbying. Another related explanation is that prominent venture capital firms lobby at the industry level rather than the individual company level. Kleiner Perkins Caufield & Byers, for instance, lobbied on behalf of legislation that benefitted ethanol producers, the HITECH Act (part of the stimulus package), the Green Taxis Act of 2009, the Safe Climate Act, the Home Star Energy Retrofit Act of 2010, and the NST Green Jobs Act of 2010.

During the 2009 scramble to get federal funding from the stimulus package, venture-capital-backed cleantech companies rushed to hire lobbyists; here are a few examples: SmartSpark with $6 million in venture capital funding had 24 people on its staff and two teams of lobbyists; Battery Ventures told its 8 cleantech startups to put someone in charge of getting stimulus money; and New Enterprise Associates had 25 clean-energy companies in its portfolio and reported that half had lobbyists or would soon have lobbyists (Yarrow, 2009).

Nonetheless, we are surprised that a venture capital firm’s reputation apparently did not influence the administrators in the Department of Energy. Rather like the old adage of corporate purchasing agents who bought information technology, “no one ever got fired for buying IBM,” we thought—incorrectly as it turned out—that Department of Energy administrators would have played it safe by favoring cleantech companies financed by prominent venture capitalists.

**CONCLUSION AND IMPLICATIONS**

We believe that our findings have important implications for researchers, entrepreneurs, venture capitalists, policy makers, and taxpayers.

Our research shows that from the perspective of the Department of Energy, the legitimacy of a company seeking federal funding was certified in part by the sum of the company’s venture capital but not by the reputation of its venture capitalist. Although we have not discussed it in this paper, our case studies revealed that many of the companies that succeeded in getting federal
funding subsequently raised additional equity capital. Prominent examples include A123, Fisker Automotive, Solyndra, and Tesla. Tesla, for instance, urgently needed more money when it was awarded $465 million of federal funding in June 2009. Three months later it raised an additional $82.5 million of private equity; then in June 2010 it raised $226 million with an IPO. It leveraged its venture capital with federal funding then in turn leveraged its federal funding with more venture capital. So it seems that federal funding itself provided certification (Lerner, 2002)—the federal stamp of approval so to speak—thereby enhancing the legitimacy of a company, and in so doing, it facilitated the raising of more equity financing (Zimmerman and Zeitz, 2002). It’s a topic that deserves further investigation.

Deep-pocketed venture capitalists were an advantage because the more venture capital that a company had, the more federal funding that it was awarded. But a venture capitalist’s reputation did not make a difference when a company was seeking federal funding. It was an instance where venture capitalist did not add value besides the money that they invested. We were surprised that venture capitalist’s reputation did not make a difference because a big factor in legitimation is affiliations; and the leading venture capital firms claim to have the most extensive and best affiliations (Byers and Lane, 2004). ‘Higher reputation’ venture capital firms have extensive connections in Washington and spend substantial amounts on lobbyists and political contributions (Lange et al., 2013), so we wonder why we didn’t find a connection between venture capitalist’s reputation and the amount of federal funding awarded to a company. It is another topic that merits further research.

Lobbying expenditures correlated with the amount of federal funding. Here are a few examples. Solyndra spent $1.42 million on lobbying and received $528 million of federal funding; A123 spent $990,000 on lobbying and received $249 million of federal funding; and Tesla, whose lobbying expenditure from 2007-2011 was $480,000, received $465 million of federal funding. SolarBridge (née SmartSpark), which spent $20,000 on lobbying, got $3.8 million of federal funding to augment its $6 million of venture capital. Our findings indicate that the more money that a company spent on lobbying, the more federal funding it received. Lobbying seems to have boosted a company’s legitimacy in the eyes of the Department of Energy.

The implication for entrepreneurs is that they should have as much venture capital as possible before they seek federal funding. They should not count on their venture capitalist’s reputation and lobbying to enhance fund
raising efforts in Washington. Rather, they should be responsible for their own lobbying, and they should not stint on how much they spend on lobbyists.

The U.S. Department of Energy behaves like a surrogate venture capitalist investing in early-stage cleantech companies, which we discovered are, on average, leveraging each dollar of real venture capital with 99.5 cents of ‘virtual venture capital’ from the government. It raises an interesting public policy issue. Federal funding is subordinate to venture capital in a bankruptcy; therefore, federal agencies bear more downside risk than venture capitalists, but don’t participate in upside returns. Both Solyndra and A123 failed and the government lost at least $500 million. In contrast, Tesla succeeded and its stock price increased more than fourfold in 2013. Tesla’s government funding ($465 million) was more than twice its venture capital financing ($213 million). Tesla repaid its entire federal funding plus $12 million interest in May 2013. But unlike Tesla’s venture capitalists, whose investments returned at least 10x and as much as 57x, the government got no risk premium whatsoever… zero financial reward for risking more than twice as much money as the venture capitalists! The following excerpt from Hargadon and Kenney (2012) sums up the situation:

For investors, such government loan guarantees are desirable because they do not dilute the entrepreneur’s or investors’ equity and have no provision for the government to share in the rewards of success. Ira Ehrenpreis of Technology Partners [an investor in Tesla] put this very succinctly: “When I add up the dollars we have received from non-dilutive government funds in the first decade: less than $5 million. In the last two or three years, we have received almost a $1 billion across almost a dozen [cleantech] portfolio companies.” (Deloitte, 2009). If the firm fails, the loans will not be repaid; while if the firm succeeds, the government will capture none of the gains.

We think this has important implications for policy makers and taxpayers. We wonder if the U.S. venture capital industry with its clout in Washington will be lobbying for more federal ‘subsidies’ like the cleantech bonanza. ‘Subsidies’ have radically altered the venture capital classic business model when it comes to cleantech investing (Lange et al., 2013) and have the potential to change it for other industry segments. Could health care and medical devices be next?
Contributions

Our research measured performance with the amount of federal money awarded to a company, in contrast to almost all other venture capital reputation and value-added studies, which have used IPO-related measures of performance. All our measures are objective and quantitative. Also we used ratio scales not only to measure performance, but also to measure the amount of venture capital and lobbying expenditure. We rate a venture capital firm’s reputation with a categorical quantitative measure. As far as we are aware, our study is not only the first to measure quantitatively the effects of lobbying on cleantech awards by the Department of Energy, but it is also one of only a handful of quantitative studies into the relationship between lobbying expenditure and federal funding at the company level. We found no evidence of value added by the reputation of venture capital firms, which is contrary to the results of most, if not all, of the previous quantitative studies with ratio scales. But it is in harmony with Rosenbusch et al’s (2013) meta-analysis of 76 empirical samples comprising 36,567 companies; they found no value-added when industry effects were controlled.

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www.deloitte.com/dtt/cda/doc/content/us_tmt_2009vcreport_060809.pdf


OpenSecrets.org (2013). Data on venture capital lobbying and political campaign contributions is from OpenSecrets.org. All lobbying expenditures come from the Senate Office of Public Records. Data for the most recent year was downloaded on March 4, 2013.


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1 This paper was presented at the ICSB 2014 World Conference on Entrepreneurship, Dublin, Ireland, June 11-14, 2014.

We thank Akshat Gupta, Jason Narcoonis, and Nicholas Wong for their invaluable contributions to this paper.
ENTREPRENEURIAL ALERTNESS IN OPPORTUNITY IDENTIFICATION AND OPPORTUNITY DEVELOPMENT

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University of Tennessee at Chattanooga

ABSTRACT

Opportunity recognition, evaluation, and exploitation are considered by many to be the heart of entrepreneurship (Shane & Venkataraman 2000; Zahra, 2008) and a construct well connected to opportunity recognition is entrepreneurial alertness. In this paper, a model is presented to extend the contributions already made in this area, particularly the work of Tang, Kacmar, & Busenitz (2012) and Valliere (2013), by further delineating the components and antecedents of entrepreneurial alertness, connecting the construct to opportunity identification and opportunity development, and introducing entrepreneurial intention as a moderating factor. The proposed model offers a framework for debate, future research consideration, and prescriptive guideline development.

INTRODUCTION

Opportunity recognition, evaluation, and exploitation are considered by many to be the heart of entrepreneurship (Aldrich & Ruef, 2006; Shane & Venkataraman, 2000; Zahra, 2008). One construct that is well connected with opportunity recognition is entrepreneurial alertness. Introduced by Kirzner (1973), entrepreneurial alertness refers to flashes of superior insight in discovering opportunities. Since its introduction, entrepreneurial alertness has been the focus of a significant body of research, with the most recent contributions providing clarification of construct antecedents (Valliere, 2013) and development of a multi-dimensional scale (Tang et al., 2012). The purpose of this paper is to extend the work in entrepreneurial alertness, particularly the most recent contributions by Tang et al. (2012) and Valliere (2013) by further delineating the dimensions of entrepreneurial alertness and its antecedents, connecting the construct to opportunity identification and opportunity development, and introducing entrepreneurial intention as a moderating factor.
Tang et al. (2012) point out the limited understanding of the role of alertness in the process of identifying new opportunities. I address this concern here by positioning entrepreneurial alertness in the broader context of opportunity development (i.e. creation) versus opportunity identification (i.e. discovery). Also, I extend Ardichvili, Cardozo, and Ray’s (2003) work, which placed entrepreneurial alertness as an antecedent to both opportunity discovery and creation, and Zahra’s (2008) work, which emphasized an iterative exchange between opportunity discovery and creation. Similar to Tang et al. (2012), I define entrepreneurial alertness as a multi-dimensional, cognitive capability. And using Tang et al.’s (2012) work as a base, and also drawing from Valliere (2013) and Puhakka (2011), I further delineate the components and antecedents of the entrepreneurial alertness construct.

Valliere (2013) argues that intentionality influences entrepreneurial alertness through the mechanism of schematic priming. He also discusses how the entrepreneurial intention literature is more focused on the antecedents of intention, based on the theory of planned behavior (Ajzen, 1991), then on how entrepreneurial intention becomes manifest in the ability to spot opportunities. He points out the need to connect the entrepreneurial intention literature with research in opportunity recognition. Tang et al. (2012) also discuss how affect and passion, which can be considered to be related to intention, could lead to cognitive processes such as entrepreneurial alertness, citing Baron (2008), Baron and Tang (2011), and Cardon, Wincent, Sing, and Drnovsek (2009). By positioning entrepreneurial intention as a moderating factor, I address these questions where intention is considered to be a facilitator in the application of entrepreneurial alertness in identifying and developing opportunities.

The importance of entrepreneurial alertness to our economy and society in general is well established (Kirzner 1973, 1999, 2008; Tang et al., 2012; Valliere, 2013). Here, I hope to extend the important contributions that have already been made in this literature. The proposed model offers a framework for debate, empirical consideration, and prescriptive guideline development. After exploring entrepreneurial alertness, its antecedents, and its consequences through a review of the literature and development of a model, I conclude with a discussion regarding future research and practical applications for this critical area in entrepreneurship.
LITERATURE REVIEW

Early Developments in Entrepreneurial Alertness and Related Areas

Kirzner’s (1973) introduction of entrepreneurial alertness as *flashes of superior insight* was grounded in the concept of opportunity discovery. The view of opportunities through the ‘discovery’ lens considers opportunities to exist regardless of the actions of an individual – due to changes in market conditions, technology, society, etc.; the opportunity will exist no matter if it is detected or not. Within this view, then, opportunity discovery is considered to be a serendipitous event. The challenge with this approach is there is no way to determine how to improve one’s capabilities in discovering opportunities.

Early research in entrepreneurial alertness was also grounded in opportunity discovery. Kaish and Gilad (1991) tested Kirzner’s (1973) theory of alertness, asserting that entrepreneurs are more alert to new opportunities and use information differently than executives. The premise behind their research was that entrepreneurs ‘discover’ opportunities more adeptly than managers of large companies. Gaglio and Taub (1992) attempted to operationalize opportunity recognition as a set of cognitive processes, considering this recognition to be a ‘discovery’ of an existing opportunity. And Busenitz (1996) replicated Kaish and Gilad’s (1991) study, finding little empirical support and the need for further development of the measures for entrepreneurial alertness. Busenitz (1996) presented the entrepreneur as an opportunity identifier who detects underpriced products or factors of production and recognizes the potential for profit due to this disequilibrium.

Research related to entrepreneurial alertness, primarily concerning factors that can influence an individual’s ability to discover opportunities slowly emerged. Busenitz and Barney (1997) and Baron (1998) introduced heuristics in entrepreneurship, describing them as cognitive biases that help guide decision-making under conditions of environmental uncertainty and complexity. While the limitations of heuristics are recognized, these authors emphasized their benefit as simplifying the decision-making process so that one is not overwhelmed with information. Within the concept of entrepreneurial alertness, heuristics are considered to be tools that speed up the process of evaluating information so that the opportunity can stand out clearly, rather than being pulled down in a fog of information. Shane (2000) demonstrated through in-depth case studies that recognition of any given opportunity is a cognitive accomplishment,
dependent upon the entrepreneur’s knowledge and prior experience. Shepherd and DeTienne (2005) found empirical support for this in their study of prior knowledge, potential financial reward, and opportunity identification. Thus, according to these authors, prior knowledge and experience act as antecedents to entrepreneurial alertness. Finally, Krueger and his colleagues (Krueger & Brazeal, 1994; Krueger, 2000; Krueger, Reilly, & Carsrud 2000; and Krueger, 2007) have conducted a significant level of research in the area of entrepreneurial intention. Their work is primarily based on the Ajzen-Fishbein framework (Ajzen, 1991) of intentionality, and Shapero’s model of the entrepreneurial event (1985), where the decision to pursue entrepreneurial activity is based on the pre-existing belief that these endeavors are both desirable and feasible. While entrepreneurial intention is related to entrepreneurial alertness and opportunity recognition, a direct connection has not yet been identified, as pointed out by Valliere (2013).

**Opportunity Discovery versus Opportunity Creation**

Since Kirzner’s introduction of entrepreneurial alertness, a theory of opportunity creation has emerged which has challenged the existing framework of opportunity discovery, on which entrepreneurial alertness was based. Sarasvathy, Dew, Velamuri, and Venkataraman (2003) developed three distinct definitions of opportunity to provide clarification. Opportunity recognition occurs when the existence of both supply and demand is obvious. The entrepreneur “recognizes” the existence of supply and demand as an opportunity and implements this match through exploitation of existing markets. Examples given by Sarasvathy et al. (2003) include arbitrage and franchises. Opportunity discovery occurs when only one side exists, either supply or demand, and the non-existent side must be discerned and then matched. Examples given include cures for disease and applications for new technologies. Opportunity creation occurs when neither supply nor demand exists or they are not obvious. Thus, the opportunity must be created through economic interventions such as marketing or finance. Examples given include Edison’s General Electric and U-Haul. For the purpose of this paper, opportunity recognition and opportunity discovery can be combined into opportunity discovery, referring to the concept that opportunities exist regardless of the actions of an individual – due to changes in market conditions, technology, society, etc.; the entrepreneur must then
“discover” and exploit the opportunity. Opportunity creation refers to deliberate action by individuals or teams to create supply and/or demand.

Taking this approach, the act of creation will often occur even when the opportunity involves more discovery exploitation. There will always be some shaping and creating that must happen. This point is emphasized by Ardichvili et al. (2003) who introduced the opportunity identification triad – recognition, evaluation, and development – as the opportunity development process. According to Ardichvili et al. (2003) opportunity is a development process rather than a one-time ‘eureka’ event. These authors also emphasize that the opportunity development process is cyclical and iterative, with an evaluation component. Thus, the entrepreneur’s judgment capabilities play an important role in how an opportunity develops. As noted by Ardichvili et al. (2003), an entrepreneur may evaluate an opportunity several times during its development, and these evaluations may lead to adjustments to the initial model or to additional opportunities.

Alvarez and Barney (2007) and Zahra (2008) provided support for Ardichvili et al. (2003). Alvarez and Barney developed distinct theories of discovery and creation, noting the implications for different entrepreneurial actions depending on the context. Zahra (2008) also emphasized a contextual view, noting that some contexts are more conducive for discovery, while others promote the discovery and creation of opportunities. Zahra (2008), like Ardichvili et al. (2003) emphasized that discovery enriches creation which, in turn, fosters discovery of more opportunities. Thus, opportunity discovery and opportunity creation work in a virtuous and dynamic cycle.

**Recent Developments in Entrepreneurial Alertness**

Recently, major advancements have been made in the area of entrepreneurial alertness. Tang et al. (2012) developed a 13-item alertness scale consisting of three dimensions: scanning and search, association and connection, and evaluation and judgment. These authors also provide a review of Kirzner’s later work in entrepreneurial alertness, which incorporates passive and active search (i.e. moving beyond serendipitous discovery), creativity, and evaluations of opportunity that evolve over time. This later work by Kirzner demonstrates a shift toward the opportunity creation mindset and lines up well with Ardichvili et al.’s (2003) view of the opportunity identification triad as a cyclical, iterative process with an evaluation component.
In the following year, Valliere (2013) introduced a model of antecedents to entrepreneurial alertness through the application of schemata. In this model, entrepreneurial expertise positively influences the richness of value-creating schemata, which refers to the capability to detect differences and possibilities between and within situations. Entrepreneurial practice positively influences the association of value-creating schemata, meaning the ability to recognize connections and patterns within stimuli, such as changing markets and technologies. And entrepreneurial intention influences the priming of value-creating schemata, one’s sensitivity to opportunity stimuli. Valliere’s (2013) model includes prior knowledge, experience, heuristics (schema), and entrepreneurial intention. Within this model, entrepreneurial alertness occurs as a result of either unbidden serendipity or scanning and search behavior. Thus, it can involve either discovery or creation. Unlike Tang et al. (2012), there is no evaluation and judgment component in Valliere’s model of entrepreneurial alertness, as these are perceived to occur after opportunity identification. Valliere also makes note of the paucity of knowledge regarding entrepreneurial intention and its role in the entrepreneur’s ability to spot opportunities.

Neither Tang et al. (2012) nor Valliere (2013) include creativity in their models of entrepreneurial alertness and its antecedents, although Tang et al. mention that creativity is part of pattern recognition and acknowledge that Kirzner allows for creativity and opportunity development in his later work. Puhakka (2011) provides an interesting perspective on entrepreneurial alertness, opportunity, and the role of creativity. Taking a “creative-cognitive” perspective of entrepreneurial alertness, Puhakka considers entrepreneurial alertness to be creativity that involves “processing complex information into original and unexpected results” (Puhakka p.91). Using the example of a jigsaw puzzle, Puhakka explains how it is solved by systematically putting the pieces into place. Entrepreneurial alertness, however, is not that type of puzzle. Rather, an entrepreneur must use his/her own creativity to determine the meaning of each piece and its relevance to the other pieces, and then create a solution. Thus, opportunity is really about creating a meaning from various stimuli, i.e. changes, in markets, technology, etc. Puhakka’s approach embraces the concept of the entrepreneur shaping the opportunity by utilizing his/her own creativity, experiences, and prior knowledge. Under this creative-cognitive model, entrepreneurial alertness is the creative behavior of the entrepreneur that results from cognitive processing of complex information. This view is supported by the earlier work of Gaglio and Katz (2001) who argue that greater creativity is a
result of more complex schema that provides concept elaboration and cross linkages, as well as the ability to break the existing mean-ends framework. In addition, as these authors point out, the breaking of existing mental frameworks as a requirement for innovation is well established in the creativity literature (Amabile, 1983; Csikszentmihalyi, 1996).

**MODEL DEVELOPMENT**

The model presented in this paper is based on recent developments in entrepreneurial alertness and opportunity creation. This model, which is presented in Figure 1, is primarily based on Tang et al. (2012) with significant reliance on Valliere (2013) and Ardichvili et al. (2003), and reference to Puhakka’s (2011) creative-cognitive concept of entrepreneurial alertness.

**Antecedents and Components of Entrepreneurial Alertness**

Entrepreneurial alertness is defined as a cognitive capability that positively influences both opportunity identification and opportunity development. Like Tang et al. (2012) it is proposed to consist of three components. Two of these -- pattern recognition and evaluation -- are the same as in Tang et al.’s definition, while the third -- perception -- is different. As shown in Figure 1, there are four antecedents to entrepreneurial alertness: scanning and search, prior knowledge, experience, and creativity. Comparing this description to Tang et al. (2012), scanning and search behavior has been moved to an
antecedent and replaced by perception as the third component in entrepreneurial alertness. The reason for this change is that perception is considered here to be a cognitive capability, similar to the capability to recognize patterns and connections between events and data, and the ability to evaluate. Scanning and search is considered to be a behavior that results in a higher capacity for entrepreneurial alertness. As emphasized by Tang et al. (2012), scanning and search behavior is critical for building a knowledge base and laying the foundation for cognitive frameworks. Perception, however, involves insight or intuition so that the entrepreneur can discern from current patterns and trends that an opportunity exists. Ardichvili et al. (2003) considered perception to be an element in the core process of opportunity identification and development, and a consequence of entrepreneurial alertness. In Ardichvili et al.’s theory, opportunity perception, discovery, and creation are part of an iterative process with development and evaluation, where the result is either venture formation or abortion. In the model presented here, perception is considered to be part of entrepreneurial alertness as it involves a cognitive capability to recognize the unique facets of any situation. The inclusion of perception as a component in entrepreneurial alertness is supported by Gaglio and Katz (2001) who discuss Kirzner’s view that alert individuals have accurate perception and interpretation. Gaglio and Katz also hypothesize that entrepreneurially alert individuals are able to process information quickly without sacrificing accuracy. Thus, they do not need to satisfice timeliness for information processing accuracy.

Pattern recognition involves “receiving new information, creativity, and making extensions in logic” (Tang et al. 2012, p. 80). Further support for pattern recognition as a factor in opportunity identification is found in Baron (2006) and Gaglio and Katz (2001). Baron theorized that cognitive frameworks are used to perceive patterns among events, trends, and changes, and from these patterns emerge the recognition of potential new ventures. Baron discusses alertness to opportunities as part of this process. Galio and Katz (2001) consider cross-linkages among schema to exist in entrepreneurially alert individuals. These cross-linkages are considered here to be a type of pattern recognition.

Evaluation in the context of entrepreneurial alertness involves assessing new information and determining if it presents an opportunity. Tang et al. (2012) referred to McMullen and Shepherd’s (2006) evaluation of Kirzner’s theory of alertness, which refers to the attention stage of evaluation. And Gaglio and Katz (2001) assert that alert individuals apply skepticism while interpreting new information, questioning and sometimes challenging their initial view and how
the new information should be applied. Also, Ardichvili et al. (2003) include evaluation as part of the opportunity identification and development process that is a consequence of entrepreneurial alertness. These authors also describe Phillips’ (1991) two different types of evaluation, summative and formative. A summative evaluation refers to a yes or no type of decision, where it is determined if an opportunity will receive resources or not. A formative evaluation involves more of a redirection of effort and resources. This is similar to Mintzberg and Waters’ (1985) concept of “emergent strategy,” and is the type of evaluation considered to be a component of entrepreneurial alertness in this paper. Formative evaluation can also be considered as part of the opportunity shaping process.

Two of the antecedents presented here, prior knowledge and experience, are similar to Valliere’s (2013) antecedents to entrepreneurial alertness, entrepreneurial expertise and entrepreneurial practice. Prior knowledge and experience are well accepted as playing a vital role in the ability to recognize opportunities (Shane, 2000) and more specifically for their role in entrepreneurial alertness (Tang et al., 2012; Valliere, 2013). Creativity is only considered indirectly in Tang et al.’s model as part of pattern recognition, and it is not part of Valliere’s definition of entrepreneurial alertness. It is recognized as an important element in entrepreneurship, however (Spinelli & Adams 2012), and Puhakka (2011) considered creativity to be the core element of entrepreneurial alertness. In earlier work, Hills, Shrader, and Lumpkin (1999) view opportunity recognition as a creative process. Here, it is applied as an antecedent to entrepreneurial alertness. Finally, scanning and search behavior, as an antecedent, recognizes that information must first be collected in order for opportunity identification to occur. There are some similarities here between scanning and search behavior and Ardichvili et al.’s (2003) social networks as an antecedent to entrepreneurial alertness, as these social networks are viewed as “bridges” to information.

Consequences and Moderating Factor

Kirzner (1979) defines entrepreneurial alertness as a unique set of perceptual and cognitive processing capabilities that determine the opportunity identification process. Kirzner’s definition is the cornerstone of the model presented in this paper, with the opportunity identification process extended to include opportunity development. As shown in Figure 1, opportunity
identification and opportunity development are consequences of entrepreneurial alertness. Similar to Ardichvili et al. (2003) opportunity identification and opportunity development are iterative processes that adapt together. As development of an opportunity moves forward, both challenges and new prospects emerge that lead to the identification of different opportunities. This results in changes to the initial opportunity so that what ultimately emerges as the business model is stronger and more effective. Thus, opportunity identification and opportunity development involve ongoing discovery and creation. Both processes are continuously influenced by entrepreneurial alertness. Perception, pattern recognition, and evaluation occur throughout the opportunity identification and development processes. Individuals with higher levels of entrepreneurial alertness possess stronger perception, pattern recognition, and evaluation skills. These consequently serve as positive influences on opportunity identification and development. The antecedents to entrepreneurial alertness – scanning and search, prior knowledge, experience, and creativity – also provide continuous influence on the iterative process of opportunity identification and opportunity development. The result is an ongoing shaping of the opportunity through both discovery and creation that is continuously influenced by entrepreneurial alertness.

The ongoing cycle presented in Figure 1 is also based on the theories presented in Alvarez and Barney (2007) and Zahra (2008). As emphasized by these authors, the situational context will determine the appropriateness of a discovery or creation focus. Alvarez and Barney (2007) explain how in certain situations, the new venture will follow an established path determined by prior knowledge, experience, and stable current conditions; a discovery context. In others, the entrepreneur’s actions during the founding of the venture and throughout its lifecycle determine its path; a creation context. In the latter context, the decision-making is iterative and incremental. Thus, decision-making follows Mintzberg and Waters’ (1985) concept of emergent strategy. Zahra’s (2008) emphasis on a virtuous cycle of discovery and creation also supports the iterative process presented here. As pointed out by Zahra, discovery and exploitation of an opportunity can sometimes lead to the recognition and creation of additional opportunities. Zahra’s theory is applied in the model presented in this paper as a virtuous cycle which occurs through a continuous, adaptive process of opportunity shaping. Entrepreneurial alertness and its antecedents provide continuous influence on this cycle, resulting in the capacity for ongoing adaptation as the context changes.
Entrepreneurial intention is displayed in Figure 1 as a moderating factor. Valliere (2013) included entrepreneurial intention as an antecedent to the priming of value-creating schemata in his model of entrepreneurial alertness. Valliere recognizes, however, that the entrepreneurial intention literature does not distinguish how entrepreneurial intention influences the ability to identify opportunities. Rather, the focus of this research stream has been on the antecedents of entrepreneurial intention (Krueger et al., 2000; Shapero, 1982). Here, a response is given to Valliere’s call to determine the role of entrepreneurial intention in opportunity identification.

As explained by Gaglio and Katz (2001), Kirzner (1979, 1985) defined alertness in two ways: first, from a passive perspective as opportunity discovery “without search” (1979, p. 48), and second, from an active perspective as “motivated propensity of man to formulate an image of the future” (1985, p. 56). Gaglio and Katz (2001) emphasize that the majority of the research in entrepreneurial alertness has been from the ‘discovery without search’ perspective. They also encourage researchers to consider the more comprehensive “motivated propensity” definition of alertness, arguing that this approach would account for unsolicited discovery but place it in a more predictive context.

In Figure 1, entrepreneurial intention is shown as a positive moderating factor on the links between entrepreneurial alertness and both opportunity identification and opportunity development. Drawing from Kirzner (1979, 1985) and Gaglio and Katz (2001), entrepreneurial intention acts as the ‘motivated propensity’ that is needed to apply the cognitive capabilities of perception, pattern recognition, and evaluation that make up entrepreneurial alertness. Thus, entrepreneurial alertness is more likely to result in opportunity identification and opportunity development for those who intend to engage in entrepreneurial pursuits. This follows Valliere’s (2013) reasoning that entrepreneurial intention positively influences the priming of value-creating schemata. Here, entrepreneurial intention enhances the utilization of entrepreneurial alertness in the identification and development of opportunities. Gaglio and Katz (2001) provide further support for entrepreneurial intention as a motivating factor in the utilization of entrepreneurial alertness in their discussion of the time limitedness involved in opportunity identification. There is a window of opportunity for exploitation. Entrepreneurial intention acts as the motivator to apply the cognitive processing involved in entrepreneurial alertness to opportunity
identification and development, rather than waiting too long and missing the window of opportunity for exploitation.

Discussion and Future Research

A better understanding of entrepreneurial alertness and its influence on opportunity identification and opportunity development is critically important to our economy and society (Kirzner, 2008; Tang et al., 2012; Valliere, 2013). The goal with this paper is to extend the contributions already made in this research stream, offering a framework for debate and future research. First, I have provided further delineation of the entrepreneurial alertness construct by introducing perception as a component, and considering scanning and search behavior as an antecedent. Prior knowledge and experience are also presented as antecedents, with support from previous research (Tang et al., 2012; Shane, 2000; Valliere, 2013). And creativity is introduced as an antecedent with support from Puhakka (2011) and Hills et al. (1999). A second contribution is made by answering Valliere’s (2013) call to connect the entrepreneurial intention literature with research in opportunity recognition. This is accomplished by positioning entrepreneurial intention as a moderator on the links between entrepreneurial alertness and both opportunity identification and opportunity development. Support for this is found in Gaglio and Katz (2001) and Kirzner (1979, 1985) through Kirzner’s ‘motivated propensity’ definition of entrepreneurial alertness. Entrepreneurial intention provides the motivation to apply entrepreneurial alertness in opportunity identification and opportunity development.

A third contribution of this paper is the connection established between entrepreneurial alertness and opportunity identification and opportunity development. Placing entrepreneurial alertness in this broader context requires consideration of the debate between opportunity discovery and opportunity creation. In this paper, I extend the theory developed by Ardichvili et al. (2003), Alvarez and Barney (2007) and Zahra (2008) by considering opportunity identification and opportunity development as an iterative, ongoing process that involves constant adaptation. Entrepreneurial alertness is incorporated as an antecedent with continuous influence on the ongoing discovery and creation that is occurring through opportunity identification and opportunity development.

Finally, a fourth contribution of this paper is the framework it provides for future research; however, there are many challenges to overcome in this area,
particularly with empirical analysis. Tang et al. (2012) developed and tested an entrepreneurial alertness scale. Thus, the components of entrepreneurial alertness and its antecedents proposed here can be empirically evaluated through careful item development, testing, and refinement. Opportunity identification and opportunity development as a consequence of entrepreneurial alertness, however, is a more daunting task. These studies may be best suited for experimental design or longevity research to avoid bias. But these approaches still do not answer how to test the creation and adaptation activities involved in opportunity development. Neither do they provide a way to test the iterative activities involved in opportunity identification and opportunity development. Finally, testing entrepreneurial intention as a moderating factor is dependent upon successfully testing entrepreneurial alertness, opportunity identification and opportunity development.

Of the four antecedents to entrepreneurial alertness proposed here, creativity is the least understood in its effects on entrepreneurial alertness and opportunity recognition and development. Puhakka (2011) considers entrepreneurial alertness to be creativity itself, which lines up with earlier work by Hills, Shrader and Lumpkin (1999) who considered opportunity recognition to be a creative process. It is clear that creativity plays a role in entrepreneurial alertness, opportunity identification and, especially, opportunity development as this in and of itself is an act of creation. Just how creativity affects these processes and how this effect can be enhanced remains to be discovered.

The components of entrepreneurial alertness also need to be investigated at a deeper level. The concept of perception as one of the components is part of Kirzner’s (1979) initial description of entrepreneurial alertness as a set of perceptual and cognitive processing skills. Despite this early reference, research regarding perception and the factors influencing it is surprisingly limited. A deeper understanding of the perception construct and how it can be enhanced in the context of entrepreneurial opportunities is needed. Pattern recognition, also rooted in Kirzner, has received some attention (Gaglio & Katz, 2001; Baron, 2006; Tang et al., 2012, and Valliere, 2013). Gaglio and Katz (2001) consider pattern recognition through schema cross-linkages and also incorporate creativity through schema complexity and the concept of breaking the means-end framework. Valliere (2013) addresses pattern recognition in his study of entrepreneurial alertness through the association of value-creating schemata. Finally, the evaluation component has also received some attention (Gaglio & Katz, 2001; Tang et al., 2012). Gaglio and Katz (2001) apply schemata to the
evaluation component, arguing that skepticism about information perceived and challenges to the initial frame of reference are needed. Previous research indicates the potential both pattern recognition and evaluation offer to entrepreneurial alertness; research probing deeper into how these cognitive processing skills can be developed and enhanced, as well as applied in opportunity recognition and development, is needed. Studies examining schema offer significant potential in these areas.

In addition to providing a framework for future research, the model provided in this paper can be used as a guide for practical application. Regarding the antecedents, it has been demonstrated that scanning and search behavior improves entrepreneurial alertness and opportunity recognition. Actively engaging in this behavior and seeking out social and professional connections can enhance its benefits. Prior knowledge and experience also increase alertness and opportunity identification and development. Building an entrepreneurial team with deep knowledge and experience in complementary industries, technologies, and skills offers the most benefit for a new venture. Of the four antecedents presented in this paper, the least is known about creativity and the role it plays in entrepreneurial alertness and opportunity identification and development. Engaging in creative exercises, building a creative team, and developing a work culture that values creativity are all activities with potential benefits for a developing venture.

Considering the components of entrepreneurial alertness presented here, the least is known about perception and how to improve it. Referring to Gaglio and Katz’s (2001) discussion of accuracy versus timeliness in entrepreneurial alertness, a recommended approach is to develop a culture that encourages accuracy in assessing situations and events, while balancing this assessment with the intention to progress (i.e. entrepreneurial intention). That is, developing a culture that values accuracy without sacrificing timeliness to take advantage of opportunities. Pattern recognition and evaluation can also be encouraged by helping employees develop skill in identifying patterns in events and industry conditions, as well as developing a culture that is open to questioning and challenging the status quo. Finally, understanding that opportunity identification and opportunity development is an ongoing, iterative, and adaptive process indicates the importance of flexibility in entrepreneurial leadership. Being open to change and making adjustments over time is critical.

Considering the importance of opportunity identification and opportunity development, research regarding entrepreneurial alertness and its connection to
entrepreneurial opportunities will hopefully continue. Although significant progress has been made in these areas, much remains to be discovered. It is the hope of this author that the model provided in this paper extends theoretical developments already achieved and offers inspiration and guidance for further research.

**Keywords:** entrepreneurial alertness, opportunity identification, opportunity development

**REFERENCES**


ANALYZING THE LINK BETWEEN STRATEGY AND PERFORMANCE: COMPARING SMALL BUSINESS OWNERS AND PROFESSIONAL MANAGERS

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ABSTRACT

This study examined the differences in the strategic choices of business owners and professional managers in the small-business context. Hypotheses posited that owners and managers would choose differing strategic orientations based upon their concern for long-term organizational success versus short-term profits. In addition, the role of education in strategic orientation for these two groups was examined. The results of this study support the contention that organizational position (owners versus managers) can impact the relationship between strategic choice and firm performance. However, we did not find a significant relationship between the educational level of the business owners or managers and strategy and performance. These findings provide insight into the strategies used by small businesses, as well as the strategic orientation differences between owner-operators and professional managers hired to run small businesses.

INTRODUCTION

Numerous reports have shown that small businesses serve as a key element of innovation and job creation within the U.S. economy (Small Business Administration, 2012). However, research has shown that these businesses are started by creative people with varying intentions, and then managed and operated based on different types of strategic choices. Some of these individuals are more entrepreneurial in nature while others are better defined as small business owners. This study examines the strategic choices of entrepreneurs versus small business managers to determine how they may differ in developing and growing the business venture. Specifically, we examine the use of internal
and external strategies and the impact these strategic choices have on firm performance (see Figure 1).

Entrepreneurs and small business owners come from a wide variety of backgrounds and experiences, and their business ventures are managed based on these difference intentions and perspectives. Adopting Penrose’s (1959) resource based view that organizations are groupings of resources, capabilities and competencies leads to the premise that a manifest competitive advantage can be developed when one’s resources and/or competencies are unique and hard to reproduce (Penrose, 1995). Organizational performance has also been examined in the literature as a function of distinctive human resources (Miller & Ross, 2003) and how a firm blends its resources and its product or service capabilities (Wernerfelt, 1984). Furthermore, the role of business strategies and practices have been emphasized by numerous researchers (Gibson, 2012; Gibson, McDowell, & Harris, 2011; Harris, McDowell, Zhang, & Gibson, 2011; Sriram, Mersha, & Herron, 2007) as key aspects impacting organizational performance. Greater knowledge of all these factors typically accompanies experience; this learned expertise of more experienced business owners likely plays a significant role in determining their patterns of business startup and organizational performance (Harris & Gibson, 2008; Harris, Gibson, & Mick, 2009; McDowell, Harris, & Gibson, 2010).

Starting and sustaining a successful business represents a substantial challenge regardless of the past experiences of the owners. Augier and Teece (2009) argued that the distinction between the functions or entrepreneurs and managers has necessarily diminished as a result of today’s open economies. If this is true regarding their functions, our objective is to learn more about the strategies used by these individuals in small businesses and to determine if the type of manager (entrepreneur/owning-manager versus non-owning manager) impacts these strategic choices. Small business owners are often faced with substantial challenges during both the startup and growth phases of business development and any additional knowledge can be used to better prepare others interested in new venture creation. Our findings may also help small business assistance programs offer more tailored strategic counseling based on the owners’ background and intentions.

**LITERATURE REVIEW**

**Strategic Focus**

In order to be successful, a business must create a set of resources that lead to a competitive advantage. Examples can include both tangible items (e.g. capital, equipment, location) and those resources that are more difficult to quantify such as specialized knowledge, managerial acumen, or business
processes and procedures. Research by Mazzarol, Reboud, & Soutar (2009) indicates there is a relationship among business resources, strategic approach and organizational performance. For small businesses, these resources are often highly correlated with the talents and skills of the business owner (Runyan, Huddleston & Swinney, 2006); research by Brush, Greene, and Hart (2001) indicated that the intangible knowledge of a business owner was a key resource for business start-ups. Furthermore, the owner shapes the strategic orientation of the new venture (Becherer, Finch, & Helms, 2006; Gilbert, McDougall, & Audretsch, 2006; Lumpkin, McKelvie, Gras, & Nason, 2010). For businesses to be successful, business owners must marry their organizational competencies with their individual resources in a manner that yields sustainable advantage; these resource combinations help explain firm performance in the resource-based view.

Strategic knowledge is a perquisite for firm success and long-term viability; knowledge about the marketplace, the opportunities within the marketplace, and the correct business approach to take advantage of opportunities is necessary for success (West and Noel, 2009). Likewise, Wiklund and Shepherd (2003) suggest that new venture creation is predicated upon an understanding of strategic approach and this knowledge is often the result of similar prior business experiences and situations.

There are two dominant directions that firm strategy may take, internal or external. An internally oriented strategic approach is characterized by those that focus their energies toward developing the inner workings of the organization such as human resources management, structural efficiencies, and expenditure control and management (Gibson, McDowell, Harris, 2011; Verheul, Risseeum, & Bartelse, 2002). Common outcomes of an internal strategic orientation include an emphasis on product efficiency, process improvement, and/or financial objectives. Furthermore, product innovation and development may stem from an internal focus as a result of deeper understanding of one’s merchandise or services (Pett & Wolff, 2007).

Alternatively, firms may pursue a more externally focused strategy. These organizations are characterized by adopting business strategies that promote sales growth and new customer attainment (Gibson, McDowell, Harris, 2011; Kumar, Subramanian, & Strandholm, 2001; Trinh & O’Connor, 2002). Relationship building, marketing, and/or customer service are hallmarks of externally focused strategies (Pett & Wolff, 2007). An external focus can facilitate exploring strategic relationships with other organizations and new target markets; an external orientation is also exceedingly important to small businesses when contemplating international expansion (Pett & Wolff, 2007).

Edelman, Brush, and Manolova (2005) suggest that resources alone do not explain firm performance; a small business must make the best strategic choices based on its available resources. Similarly, Pett and Wolff (2007) believe
that business performance is dependent upon the best fit between a firm’s internal resources and strategic orientation and its external market conditions. The proper alliance between firm resources and strategic choices is needed to best achieve business growth and financial profitability (Edelman, Brush, & Manolova, 2005).

**Educational Attainment**

Education has been shown to be an important influence on owner-manager behavior (Storey, Watson & Wynarczyk, 1989) and contrary to the media-endorsed stereotype, the literature shows and numerous studies support the notion that entrepreneurs are better educated than the general population (e.g., Cooper & Dunkelberg, 1987; Robinson & Sexton, 1994; Kilpatrick & Crowley, 1999; and Scott, Rosa, & Klandt, 1998). In fact, a recent large survey conducted by Wadhwa, Aggarwal, Holly, and Salkever (2009) indicated that most successful entrepreneurs are well educated; 95.1 percent of those surveyed had earned bachelor's degrees, and 47 percent had more advanced degrees. In addition, 70% of those surveyed indicated education was important. This is not inconsistent with very early academic assertions; as cited by Kiesner (1984), esteemed economist Samuel Aluko stated:

“About 80% of all small business failures are attributable to inadequate planning, poor accounting, inadequate control mechanism, inability to read and understand financial statements, and the inability to accept technical and economic advice. That is the absence of sound business education and training.” (Kiesner, 1984, p. 17).

Surveys of small business owners also indicate that they perceive their college education as instrumental in their business decision making; according to Al-Zubeidi (2005) entrepreneurs reported that college education helped them run their business (69%), identify business problems (52%) and make necessary business changes (51%); each of these is consistent with choosing an appropriate business strategic focus. Indeed, anecdotal evidence indicates that returning to the classroom is a common trend among entrepreneurs. David Port (2010) cites entrepreneur Gayle Reaume as saying: "Growing a company means you need to know how the whole company works--every part of it. I've always been strong at certain things, like marketing, but I could see I was struggling with the intricacies of building and running a growth-oriented company." It seems that entrepreneurs are making the link between education and effective business strategies.

Researchers have posited that having a formalized business plan is paramount to engaging in strategic planning as it serves as the basis for making and taking strategic decisions and as a monitoring mechanism (Deekins and
Freel, 2003). Richbell, Watts and Wardle (2006) found that for entrepreneurs, education was positively correlated with having engaged in business planning thereby indicating that the more educated recognized the need for structure and the role that strategic planning play in long term success.

Small business owners and managers must have a strong understanding of their business environment and capabilities and use this knowledge to adopt the most appropriate strategic choices. The research clearly indicates that education is believed to play a role in making good strategic decisions and engaging in the strategic planning associated with successful firms. What is unknown is whether or not educational differences among owner-managers and non-owning managers result in different strategic orientations stemming from their potentially conflicting goals of long term sustainability versus immediate profit generation. Edelman, Brush, and Manolova (2005) suggest that resources alone do not explain firm performance; a small business must make the best strategic choices based on its available resources. Similarly, Pett and Wolff (2007) believe that business performance is dependent upon the best fit between a firm’s internal resources and strategic orientation and its external market conditions. The proper alliance between firm resources and strategic choices is needed to best achieve business growth and financial profitability (Edelman, Brush, & Manolova, 2005).

HYPOTHESIS

The strategies used by small business owners can be greatly influenced by knowledge gained from previous experience (Harris & Gibson, 2008). This experience can enhance their understanding of the potential obstacles in business startup, and the resources necessary to successfully operate the venture. It also provides a greater understanding of strategic analysis and decision making, and how these choices impact business performance. As proposed by Runyan, Huddleston, and Swinney (2006), the most successful small businesses have owners or managers capable of using their individual talents and experiences in a manner that creates a sustainable competitive advantage for the firm.

The strategic orientation pursued by business owners may very well be impacted by their past experiences; past research has linked strategy with business knowledge and performance (Edelman, Brush, & Manolova, 2005; Pett & Wolff, 2007; West & Noel, 2009). Whereas inexperienced business owners and managers naturally focus on customer service and their network of relationships (external orientation) as a means to develop relationships with others and thereby overcome resource and knowledge shortages (Lumpkin, et al. 2010), experienced business owners are able to rely upon their existing knowledge of process and structural efficiencies and financial objectives which is more consistent with an internal strategic orientation (Mitchell, Smith,
Reliance upon internal strategies has been associated with stronger performance by traditional small organizations (Edelman, Brush, and Manolova, 2005).

Business owners are often more focused on establishing the foundations for organizational success, whereas managers will be more focused on the short-term success of the already established organization. Owners are also generally more concerned about operations and customer service while managers are more focused on the sales and revenue growth. This would indicate that business owners often choose internal strategies focused on long-term business development, whereas managers adopt a more external strategic approach where short-term growth is emphasized. Thus, the following hypotheses are offered and the relationship is shown in Figure 1.

H1 There is a positive relationship between internal strategic focus and performance for owner-operators.

H2 There is a positive relationship between external strategic focus and performance for non-owner managers.

Figure 1.
The Relationship of Strategic Focus and Performance for Owner/Operators and Managers

In addition, education level of the owner or manager has been shown to impact the types of strategic decisions they make. We expect business owners with higher educational levels have a better understanding of the need for structure and long term success than those with lower levels of education and will be more likely to emphasize internal strategies. Conversely, non-owner managers with higher educational levels are expected to emphasize an external strategy because their studies have likely emphasized the importance of achieving immediate results. Therefore, we offer the following hypotheses:

H3 Owner-operators with higher educational levels will be more likely to utilize an internal strategy.
**METHODOLOGY**

**Sample**

The sample for this study included small business owners in North Carolina who worked with or sought help from the North Carolina Small Business Technology and Development Center. The data were collected via a survey emailed to approximately 1500 small businesses. There were 237 usable responses from the 270 surveys received which is an 18% response rate. Of the respondents, 55% were male, 50% indicated they were ethnic minorities, and they had an average age of 49.2 years old. The age of the businesses ranged from zero to 68 years with an average of 10.5 years. Of all the businesses surveyed, 53.5% indicated that they were in service, 13.1% indicated manufacturing, 13.1% retail, 10.6% construction, 6.6% medical, and 2% not-for-profit.

**Measures, Data, and Scale Analysis**

The survey collected information on gender, age, years of current ownership, and whether or not they were the owner operator or a non-owning manager. In addition, the respondents were also asked several questions that indicated strategic emphasis (Gibson, McDowell, & Harris, 2011) which assessed strategic focus. In order to evaluate construct validity of the item scores, an exploratory factor analysis was conducted on the items assessing strategy. Using factor analysis with an Eigenvalue greater than one rule (Kaiser, 1960), these items yielded two factors with Eigenvalues of 5.301 and 1.756 respectively. The first six items indicated an internal strategic focus and the next seven items indicated an external strategic focus. The factor pattern/structure coefficients including Eigenvalues and Cronbach’s alphas to examine reliability can be found in Table 1.

**Table 1. Factor Pattern/Structure Coefficients for Internal and External Strategy**

<table>
<thead>
<tr>
<th>Strategy Item Name</th>
<th>Internal Strategy Factor</th>
<th>h²</th>
<th>External Strategy Factor</th>
<th>h²</th>
<th>Mean</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monitoring and enhancing employee satisfaction and morale</td>
<td>.804</td>
<td>.64</td>
<td></td>
<td>6</td>
<td>3.42</td>
<td>1.383</td>
</tr>
</tbody>
</table>
Organizational performance was measured using 10 questions on performance (Gibson et al., 2011). These items assessed satisfaction on multiple areas of performance within an organization. Previous empirical evaluations have found these subjective measures are highly correlated with objective measures (Dess & Robinson, 1984; Vernkatraman & Ramanujam, 1986) used in the business literature (Covin, Prescott & Slevin, 1990; Greenley, 1995; Slater & Narver, 1995; Subramanian, Kumar & Strandhold, 2009). These results also indicated a good fit to the data with the items combined into a single performance measurement. The factor pattern/structure coefficients including the Eigenvalues and Cronbach’s alpha for performance can be found in Table 2.

Table 2. Factor Pattern/Structure Coefficients for Performance

<table>
<thead>
<tr>
<th>Performance Items – Satisfaction With…</th>
<th>Factor</th>
<th>$h^2$</th>
<th>Mean</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maintaining employee morale</td>
<td>.781</td>
<td>.610</td>
<td>3.57</td>
<td>1.116</td>
</tr>
<tr>
<td>Pricing products/services</td>
<td>.753</td>
<td>.567</td>
<td>3.91</td>
<td>.802</td>
</tr>
<tr>
<td>Managing staffing needs</td>
<td>.747</td>
<td>.558</td>
<td>3.61</td>
<td>1.144</td>
</tr>
<tr>
<td>Communicating with employees</td>
<td>.731</td>
<td>.534</td>
<td>3.78</td>
<td>1.140</td>
</tr>
</tbody>
</table>
Regression analysis was used to examine the data and test the hypotheses. The data were split into two groups. The first group is defined as the owner/operators and the second group is defined as the non-owning managers. Control variables, which included organizational size (number of employees) and the number of years they had been working with this company, were regressed against performance in step one of the regression analysis followed by the independent variables, internal strategic focus and external strategic focus, in step two of the two-step process. In order to examine the effect in both models, F, statistical significance of the model, beta weights and structure coefficients, the adjusted $R^2$, and the statistical significance of the independent variable are reported and examined. Each model was tested using the research model below where $Y =$ performance, $X_1 =$ number of employees, $X_2 =$ number of years with the company, $X_3 =$ internal strategy, and $X_4 =$ external strategy.

Model:  

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

RESULTS

The purpose of this study was to examine the relationship between strategic orientation and performance for small business owner operators and non-owning managers. In addition, we examined the relationship of education level and strategic focus for owner/operators as well non-owning managers with strategic focus. We hypothesized that there would be a positive relationship between internal strategic focus and performance for owner/operators and that there would be a positive relationship between external strategic focus and performance for non-owning managers. In addition, we hypothesized that higher levels of education would be associated with a positive relationship between ownership and strategic focus with owner/operators being more internally focused and non-owning managers being primarily externally focused.
To test Hypothesis 1 and 2, the data were split into two groups, those who are owner/operators and those who are non-owning managers. Ownership was determined with the use of a single question asking the respondent if they are an owner. The analysis of the first group yielded a good fit to the data. Step one of the regression analysis included entering the control variables, employee size and years of working with the business, into the model. The size of the organization has been shown in previous research to affect specific organizational processes such as communication and specialization, thus affecting performance (Indik, 1965). The age of the business was also included as a control due to the increased institutionalization (Dimaggio & Powell, 1983) that can occur the longer a firm continues to operate. After entering the control variables in step one, the predictor variables of internal strategic orientation and external strategic orientation were added in step two. The first model consisting of the control variables resulted in an ANOVA with an F-value of 2.430 ($p = .093$). The second model, with the control variables and internal and external strategy, resulted in an F-value of 8.316 ($p = .000$). While the first model was significant at the $p < .1$ level, the inclusion of internal and external strategy improved the fit with an $R^2$ of .248 and a $\Delta R^2$ of .203 that was statistically significant ($p= .000$).

In addition, the relationship of the strategy items as predictors to performance were examined utilizing standardized and unstandardized coefficients, statistical significance, and confidence intervals. For a summary of this analysis, see Table 3. The results of the regression analysis indicate that for businesses operated by the business owner rather than a manager, an internal strategic focus is statistically significantly related to performance, thus supporting Hypothesis 1.

Table 3: Summary of Analysis of Strategy Predictors to Performance of Owners

<table>
<thead>
<tr>
<th>Variable</th>
<th>$B$</th>
<th>$SE B$</th>
<th>$\beta$</th>
<th>95% CI Lower</th>
<th>95% CI Upper</th>
<th>VIF</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Step 1</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employees</td>
<td>.004</td>
<td>.006</td>
<td>.071</td>
<td>-.008</td>
<td>.015</td>
<td>1.329</td>
</tr>
<tr>
<td>Company Years</td>
<td>.008</td>
<td>.005</td>
<td>.168</td>
<td>-.002</td>
<td>.018</td>
<td>1.329</td>
</tr>
<tr>
<td><strong>Step 2</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employees</td>
<td>.002</td>
<td>.005</td>
<td>.048</td>
<td>-.008</td>
<td>.013</td>
<td>1.427</td>
</tr>
<tr>
<td>Company Years</td>
<td>.004</td>
<td>.005</td>
<td>.085</td>
<td>-.005</td>
<td>.013</td>
<td>1.385</td>
</tr>
<tr>
<td>Internal Strategies</td>
<td>.257</td>
<td>.052</td>
<td>.469*</td>
<td>.154</td>
<td>.360</td>
<td>1.194</td>
</tr>
<tr>
<td>External Strategies</td>
<td>-.026</td>
<td>.093</td>
<td>-.026</td>
<td>-.210</td>
<td>.159</td>
<td>1.215</td>
</tr>
</tbody>
</table>

Note: $R^2$ for first model = .045. $R^2$ for second model = .248. $\Delta R^2$ = .203. $p = .000$. *$p < .01$. N = 105. Two-tailed tests.
The analysis was then run with the group of non-owning managers. The model was again statistically supported with an F-value of 1.488 (\(p = .236\)) for the first model and an F-value of 7.009 (\(p = .000\)) for model 2. Model 2 improved the fit with an \(R^2\) of .369 and a \(\Delta R^2\) of .313 that was statistically significant (\(p = .000\)). The results of this regression analysis supported Hypothesis 2 in that external strategic focus was positively related to performance for non-owning managers. Table 4 provides the analysis summary.

**Table 4: Summary of Analysis of Strategy Predictors to Performance of Non-Owners**

<table>
<thead>
<tr>
<th>Variable</th>
<th>(B)</th>
<th>(SE B)</th>
<th>(\beta)</th>
<th>95% CI Lower</th>
<th>95% CI Upper</th>
<th>VIF</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Step 1</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employees</td>
<td>.001</td>
<td>.000</td>
<td>.236</td>
<td>.000</td>
<td>.002</td>
<td>1.008</td>
</tr>
<tr>
<td>Company Years</td>
<td>-.002</td>
<td>.006</td>
<td>-.050</td>
<td>-.014</td>
<td>.010</td>
<td>1.008</td>
</tr>
<tr>
<td><strong>Step 2</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employees</td>
<td>.000</td>
<td>.000</td>
<td>.110</td>
<td>.000</td>
<td>.001</td>
<td>1.079</td>
</tr>
<tr>
<td>Company Years</td>
<td>-.001</td>
<td>.005</td>
<td>-.033</td>
<td>-.012</td>
<td>.009</td>
<td>1.013</td>
</tr>
<tr>
<td>Internal Strategies</td>
<td>.152</td>
<td>.096</td>
<td>.236</td>
<td>-.040</td>
<td>.345</td>
<td>1.671</td>
</tr>
<tr>
<td>External Strategies</td>
<td>.341</td>
<td>.125</td>
<td>.398*</td>
<td>.091</td>
<td>.591</td>
<td>1.604</td>
</tr>
</tbody>
</table>

Note: \(R^2\) for first model = .056. \(R^2\) for second model = .369. \(\Delta R^2\) = .313. \(p = .000\). *\(p < .01\). N = 52. Two-tailed tests.

In order to test Hypotheses 3 and 4, the data were again split into two groups, owner/operators and managers. A correlation analysis was completed to determine the relationship of means of each group’s educational level with both internal and external strategic focus. The sample was limited as there were only 137 of the owner/operators and only 65 of the managers who indicated their educational level. For the owner/operator group, the Pearson Correlation of educational level with internal strategic focus was not statistically significant with a value of -.148. The relationship with external strategic focus was statistically significant with a value of -.234 at the \(p < .01\) level. Thus, Hypothesis 3 is not supported. Additionally, for the manager group, the Pearson Correlations between educational level and internal strategic focus and external strategic focus were not statistically significant with values of -.094 and .077 respectively. Thus, Hypothesis 4 is also not supported. These correlations as well as the means and standard deviations can be seen in Tables 5 and 6 below.
### Table 5. Correlations, Means and Standard Deviations for Owner/Operators

<table>
<thead>
<tr>
<th>Variable</th>
<th>Means</th>
<th>S.D.</th>
<th>1</th>
<th>2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Educational Level</td>
<td>4.67</td>
<td>1.316</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internal Strategies</td>
<td>3.065</td>
<td>1.120</td>
<td>-.148</td>
<td></td>
</tr>
<tr>
<td>External Strategies</td>
<td>3.899</td>
<td>.673</td>
<td>-.284*</td>
<td>.427*</td>
</tr>
</tbody>
</table>

* p < .01  
N = 139

### Table 6. Correlations, Means and Standard Deviations for Non-owning Managers

<table>
<thead>
<tr>
<th>Variable</th>
<th>Means</th>
<th>S.D.</th>
<th>1</th>
<th>2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Educational Level</td>
<td>4.60</td>
<td>1.355</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internal Strategies</td>
<td>3.205</td>
<td>1.019</td>
<td>-.094</td>
<td></td>
</tr>
<tr>
<td>External Strategies</td>
<td>3.926</td>
<td>.753</td>
<td>.077</td>
<td>.593*</td>
</tr>
</tbody>
</table>

* p < .01  
N = 65

**DISCUSSION**

The results of this study support the first two hypotheses, indicating that organizational position (owners versus managers) can impact the relationship between strategic choice and firm performance. However, we did not find a significant relationship between the educational level of the business owners or managers and strategy and performance. These findings provide a greater understanding of the strategies used by small businesses, as well as the strategic orientation differences between owner-operators and professional managers hired to run small businesses.

As hypothesized, our findings indicate that owners are more concerned with internal process and product refinements while managers adopt business strategies that promote sales and customer growth. Fortuitously, both a sustainability orientation and short term sales and market growth are instrumental to a firm’s success. Experienced business owners are often knowledgeable about organizational processes and efficiencies, which is consistent with an internal strategic orientation (Mitchell, Smith, Seawright, & Morse, 2000). It is not surprising to find that owners are more concerned with strategies that promote long-term growth and development while managers promote more short-term sales growth. Although compensation was not analyzed in this study, managers often receive compensation packages that can be maximized based on short-term success.
Research by Morrissey and Pittaway (2006) indicated that inexperienced owners or managers are likely to become emotionally involved with customers and learn through social interaction rather than formalized business practices. In addition, owners or managers with limited education often face greater obstacles when starting and operating a business (Lussier & Pfeifer, 2001). Because of these prior findings it was surprising that educational level was not significantly related to the strategic choices of either business owners or managers. More specifically, it was interesting to note that education level was not significant with either internal or external strategies for managers, but there was a significant negative relationship between business owners with lower educational levels and the use of an external strategy. This indicates that owners with lower educational levels tend to adopt strategies with a short-term focus that might sacrifice long-term viability. Perhaps these owners have a limited knowledge base compared to more educated business owners and therefore they are more focused on external strategies that produce rapid short-term gains.

Small businesses generally have access to limited resources making it important to understand how to strategically operate the venture in a manner that can best impact firm performance. As these firms gain more strategic flexibility they are better able to refine business capabilities and improve performance (Kelly, 2007). Our findings indicate a difference in the strategic choices of small business owners compared to the professional managers they hire to grow these business ventures. Perhaps the motivations of these different groups play a role in strategic choice. Business owners are often more concerned with long-term viability while managers may be more focused on short-term financial growth to demonstrate their effectiveness and possibly enhance their compensation package. One way to moderate this distinction may be to include firm-ownership as part of managers’ compensation packages.

Research has shown that without effective strategic choices there is often a waste of resources and lack of direction and sustainability in small businesses (Mazzarol, Reboud, & Soutar, 2009; West & Noel, 2009). West and Noel (2009) suggest that business owners must be rational in investing resources to start a new venture. This includes the development of the most appropriate strategies to guide the firm through the various stages of business development. One of the greatest challenges for small business owners is determining when to hire a professional manager to assume control of the business. Owners devote time and resources to develop the business, making this both a financial and emotional investment.

Once owners hire someone else to manage their businesses, they often relinquish some control of the strategic direction of the business. Our findings indicate that once organizations experience significant growth and shift from an owner-manager model to a professional manager model, decision-making is likely to transition from an internal strategic orientation to a more externally
oriented strategy focused more objectives such as on sales growth and customer expansion. In order to ensure a smooth transition it is imperative for business owners to select professional managers they are confident can both operate the business profitably in the short term and ensure future success. Owners and managers must share a common framework of expectations regarding both operations and the strategic direction of the business.

**FUTURE RESEARCH**

While this study examined the differences in the strategic choices of business owners and professional managers, additional research is needed to offer more definitive conclusions. Future research should consider examining other individual and firm factors that may impact the link between strategic orientation and firm performance within the small business context.

It is important to examine other individual characteristics of owners and managers that may impact strategic choices. In addition to owner status and level of education, other factors such as prior entrepreneurial experience of the owner/manager, total wealth of the owner/manager and the social network of the owner/manager could all have major impacts on the strategic orientation the owner adopts. These and other individualized variables may offer more insight regarding differences or similarities between these groups.

Studies may also examine firm level characteristics such as business age or size to determine if the organizational life cycle impacts firm strategy. A firm may alter its strategic approach over time regardless of whether it is governed by an owner or manager. Industry type is likely an important firm-level variable to consider. Research has shown that retail and service firms, in particular, face unique challenges that may determine more specialized strategic choices. Manufacturing firms, conversely, experience less market uncertainty and dynamism. As such, manufacturing firms may be inherently more internally focused than service firms. These additional studies must continue to collect data from a broad range of small businesses in order to gain a greater understanding of both their strategic nature and critical success factors. A vibrant and successful small business community can serve as a major catalyst for national economic growth.

**CONCLUSION**

Research has shown that businesses are started by people with certain intentions but often come to be managed and operated by differently motivated people. Our study examines the manifestation of those different intentions through the strategic focus of owner operators and non-owner managers. We hypothesize and find that owner-operators will be more interested in internal strategic initiatives aimed at securing the long-term success and viability of their
firms and that internal focus will manifest itself in improved financial performance for their firms. We also suggest and find that non-owner managers will be more interested in external strategic initiatives aimed at meeting the needs of the marketplace or responding to competitors’ actions today rather taking the long-term view of the their firm and its success. Indeed, the non-owner managers do exhibit such behavior and it is also positively associated with firm performance. This is consistent with the conclusions of Katz and Niehoff (1998) who found that strategies pursued varied based on firm-ownership, that owners and managers perceive risk differently and consequently make strategy decisions accordingly. To the authors’ way of thinking, these findings regarding differences in strategic orientation should be perceived as encouraging; they indicate that both owner-managers and non-owning managers are able to select strategies that result in financial success. What they highlight is the importance of the two having a shared belief system whereby the owner ensures the manager understands his/her values and business intentions and the manager is properly motivated to integrate these with his/her own strategic orientation.

We believe this study enhances the current literature concerning the strategic orientation of small businesses. Our findings could potentially aid small business development centers in offering more tailored strategic counseling based on the owners’ background and intentions. We have shown that owners should and do focus more on internal strategies while managers should and do focus more on external strategies. This is likely due to the owner/manager relying on their individual experiences and skill sets. Perhaps, small businesses could harness the best of both worlds by equally including an owner operator and a non-owner manager in the strategic planning process.

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Examining Entrepreneurial Characteristics, Motivations, Barriers, and Outcomes for Small versus Large Multifunctional Farm Enterprises in New England

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University of Vermont

Paul Dunn, Professor Emeritus  
University of Louisiana at Monroe

ABSTRACT

This article presents findings of a census type survey of New England farmers engaged in multifunctional agriculture (MFA), focused on comparing MFA farmers’ entrepreneurial characteristics, reasons/challenges of MFA, and self-assessed outcomes after participating in MFA. A majority of farms, regardless sizes of operations defined by annual gross cash sales, revealed similar entrepreneurial characteristics comparing to other entrepreneurs described in literature. More micro and small family farms confirmed positive experiences with the MFA focusing on connecting to customers and communities. Most farmers shared similar objectives, barriers, and concerns/outcomes compared to those of small businesses previously studied. Large farms were more interested in value added operations, while micro and small farms were more likely to be engaged in agritourism and direct sales. Not as many micro and small farms were very positive with their future outlook in agriculture, but they were certainly committed to practicing multifunctional activities in the future.

“I am very optimistic about my farm’s future, but I am not optimistic about the world.”
An Anonymous Farmer Responded to Our Survey

INTRODUCTION

Small businesses are the heart and soul of the United States. A general consensus about small businesses, especially new startup firms in the past 2-3 years, relates to job creation and net job growth in our economy. According to statistics released by the U. S. Small Business Administration (SBA, 2008) and the Census Bureau, firms with fewer than 20 employees contributed almost 83 percent of all of the net new jobs between 2004 and 2005. Unfortunately the rate
of new startups was slowing down between 2007 and 2010 due to the recession (SBA, 2012). Many challenges remain for small business owners, such as lack of incentive to expand or to grow due to financial constraints, increasing costs for healthcare and production inputs, rising concerns about global competition and market volatility, growing concerns with taxes and regulations, widening gaps in identifying and recruiting quality and qualified workforce, and dangling uncertainty in personal and family expectations. Policy makers, economic development officials, and service providers continue to seek solutions to support the spirit and resources toward entrepreneurship as the engine for future economic growth and societal stability.

Small family farms, compared to other types of small ventures, encounter some of the most unique issues beyond commonly acknowledged challenges. Many uncontrollable and unpredictable events such as changes in climate, environment, natural disasters, ecology, and biophysical elements in fields, could devastate the farming livelihood and threaten the sustainability and prosperity of farm families. According to the Census of Agriculture\textsuperscript{ii}, the number of farms has been slowing and steadily declining over time. The most recent Census of Agriculture released in 2012 showed interesting trends compared to 2007 data, for example:

1. \textit{The 2012 Census showed principal farm operators are becoming older and more diverse; following the trend of previous censuses. The average age of a principal farm operator was 58.3 years in 2012, up 1.2 years since 2007, and continuing a 30-year trend of steady increase. The Census also accounted for more minority-operated farms in 2012 than in 2007.}

2. \textit{In 2012, the United States had 2.1 million farms – down 4.3 percent from the previous Census in 2007. In terms of farm size by acres, this continues an overall downward trend in mid-sized farms, while the smallest and largest-size farms held steady. Between 2007 and 2012, the amount of land in farms in the United States continued a slow downward trend declining from 922 million acres to 915 million. This is only a decline of less than one percent and is the third smallest decline between censuses since 1950.}

Under pressure to survive and succeed, farm operators need to be entrepreneurial, and seek and create new opportunities in a highly competitive
Multifunctional agriculture (MFA) was a political strategy introduced and adopted in the early 1990s by the European countries to facilitate and promote food security and sustainable economic development (Devries, 2000; European Commission, 2012). Broadly speaking, the MFA refers to agricultural activities beyond serving the traditional role of producing food and fiber (Renting, et al. 2009, Hajnalka & Alajos, 2009; Van Huylenbroeck & Durand, 2003). While there is no specific definition or policy orientation established in the United States, farmers have been involved in MFA, particularly in the New England region (Table 1 and 2). Many small dairy farms in Vermont, for example, have introduced farm tours, offer educational and training workshops, renovate old barns to be Bed & Breakfast, and make cheese, yogurt, and ice cream. Many small farms in Massachusetts have developed closer relationships with their customers by selling at farm stands, farmers markets, and local institutions such as schools and hospitals. However, there is a stunning lack of systematic research on the linkages and interactions with respect to the MFA and its impacts on People (farmers, local residents in farming communities, and consumers), Place (communities to include farming and non-farm activities), and Prosperity (farm income and profits, health of local farming communities, quality of life for farmers/farm families and consumers or local residents) in the United States. This paper reports key findings from the largest field survey conducted in the U.S. to examine MFA in relation to four different sizes of farming operations, and the size of farming operations is defined by annual gross cash sales (adding up all cash sales from conventional agricultural products and MFA activities) to be consistent with New England farm characteristics and the USDA’s definition:

- Micro commercial farms – annual grow cash sales are between $1 and $10,000.
- Small commercial farms – annual gross cash sales are between $10,001 and $100,000.
- Medium commercial farms - annual gross cash sales are between $100,001 and $500,000.
- Large commercial farms - annual gross cash sales are over $500,000.

We define MFA in our study to include four aspects modified from the original definition introduced by the European countries – agritourism, value added, direct sales, and off farm work (Liang & Su, 2013; Liang, Su, Dunn, & Pescatore, 2012; Liang, 2012).
Table 1: Number of Farms Participating in Selected MFA in New England Region

| Source: USDA, National Agricultural Statistics Services, New England Field Office |

<table>
<thead>
<tr>
<th>Region</th>
<th>Agritourism</th>
<th>% Change</th>
<th>Direct Sales</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Connecticut</td>
<td>237</td>
<td>101</td>
<td>1,420</td>
<td>1,099</td>
</tr>
<tr>
<td>Maine</td>
<td>270</td>
<td>112</td>
<td>2,311</td>
<td>1,705</td>
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<tr>
<td>Massachusetts</td>
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<td>190</td>
<td>88</td>
<td>1,348</td>
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<tr>
<td>Rhode Island</td>
<td>68</td>
<td>43</td>
<td>376</td>
<td>249</td>
</tr>
<tr>
<td>Vermont</td>
<td>155</td>
<td>109</td>
<td>2,071</td>
<td>1,474</td>
</tr>
</tbody>
</table>

Table 2: Gross Sales ($1,000) from Participating in Selected Multifunctional Ag-Activities in New England Region

| Source: USDA, National Agricultural Statistics Services, New England Field Office |

<table>
<thead>
<tr>
<th>Region</th>
<th>Agritourism</th>
<th>% Change</th>
<th>Direct Sales</th>
<th>% Change</th>
</tr>
</thead>
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These activities have been hypothesized to enhance the long term sustainability and prosperity both of farmers and the rural communities in which they are located. Analysis and discussion presented in this paper focus on MFA farm profile and farm operators’ entrepreneurial characteristics, motivations and challenges relating to MFA operations, and farmers’ perception on MFA and its impacts on personal and family life. The long term goal of this study is to identify specific strategies and policy options that may increase the integration of local economies (communities) and farms, and to enhance the overall viability of
rural communities. In studying multifunctional farmers, we were particularly interested in the similarities between small farmers and small business people. We will begin with an overview of entrepreneurship and small business literature. Researchers have discussed ‘pull and push’ factors beyond financial incentives for people to become entrepreneurs – being bored and redundancy in current position, job insecurity, personal satisfaction, family happiness, taking control of their life, making a positive impact on the society, contributing to professional networks, and winding down in anticipation of retirement (Glancey & Malcolm, 1997; Liang, 2002; Morris, et.al., 1996; Orhan & Scott, 2001; Lee, 1997; Davidson & Honig, 2003). Many scholastic works have examined entrepreneurial individuals and their traits, characteristics, or mindset.

McClelland (1965) postulated the need for achievement among entrepreneurs as an important motive early in these studies, and other studies continued to explore several commonly observed or analyzed parameters such as optimism, realism, confidence, risk acceptance, independency, perseverance, passion, and goal oriented. Shane, Locke & Collins (2012) summarized motivation/characteristics as the need for achievement, risk taking, tolerance for ambiguity, locus of control, self-efficacy, goal setting, independence, drive, egoistic passion. A small farm is defined as an operation earning annual gross cash income less than $250,000, including commercial and noncommercial farms (USDA, 2012; MacDonald, 2010). According to the Census of Agriculture, there seemed to be a diverging trend in operations among small farms. The number of small commercial farms with annual gross cash income of $10,000 and $250,000 fell between 2002 and 2007. The number of small noncommercial farms earning less than $1,000 annual gross cash income actually increased, and these small noncommercial farms contributed to all of the growth in small farm numbers between 2002 and 2007 (USDA, 2007; Hoppe, MacDonald, & Korb, 2010; MacDonald, 2010). Although the large commercial farms contribute to 85 percent of the market value of agricultural production, small farms offer environmental and ecological benefits to support working landscape and rural lifestyle. Many of these small noncommercial farms are family farms in rural areas, and most of them rely on off farm jobs or other alternatives to make a living. Researchers speculated that some small farms are profitable, and others are willing to accept financial losses (Hoppe, MacDonald, & Korb, 2010). Our research questions were triggered by such significant shift in farming patterns – what do these small farms do to survive, how do they make decisions to engage
in farming and other activities, and what are the consequences with respect to financial situation and quality of life?

Multifunctional farm enterprise is a relatively new concept in the U.S., and has largely been addressed at the macroeconomic level to consider trade issues (Bohman, et al. 1999). In the European countries, the MFA concept has emerged as a key notion in scientific and policy debates on the future of agriculture and rural development (Renting, et al. 2009; Brouwer and van der Heide 2009). Existing literature refers MFA to agricultural activities beyond the traditional role of producing food and fiber, such as renewable resource management, landscape and biodiversity conservation, and contribution to the socio-economic viability of rural communities (Renting, et al. 2009, Hajnalka and Alajos, 2009; Van Huylenbroeck and Durand, 2003). Van der Ploeg and Roep (2003) described a triangular relationship to link MFA with farming: Broadening, Deepening, and Re-grounding. Broadening involves a farming operation diversifying its enterprises to include the production of new goods and services that encourage the linking of farm production, visitors to rural areas, and amenities of their local communities. Agritourism and specialty food sectors in the New England region are clear examples of broadening activities (McGehee, 2007; Heller, 2007; Hughes, Kennedy, and Ortego, 1999). Deepening involves refocusing agricultural production to better meet the demands of consumer and sometimes requires advancements in the agricultural supply chain. Direct local sales are examples of deepening activities. Researchers have analyzed specific marketing strategies adapted by farmers such as direct farm-to-table food marketing, roadside stands, web-based sales, community supported agriculture, small producer marketing cooperatives, pick-your-own fresh produce, and farmer’s markets (Kinsey and Senauer, 1996; Roth, 1999; Tippins, Rassuli and Hollander, 2002; Hansen, 2003; White, 1996; White, 1997; White and Manning, 1998). Finally, Regrounding activities involve the total refocusing of farm household resources, such as participating in activities outside of farming and off-farm work of farm household members.

Diagram 1 summarizes the relationships between farm household, customers/buyers, and community/other organizations. A farm household can decide to establish any combination of the MFA by choosing from agritourism, value added, direct sales, and off farm works (center section of Diagram 1). The overall goal of the study is to explore and analyze if MFA farm households satisfy the entrepreneurial theory from both the micro/individual’s perspective and the macro/economic/social/environmental aspects. This paper primarily
focuses on testing the following hypotheses: MFA farm operators exhibit entrepreneurial characteristics as described in entrepreneurship literature regardless the size of annual gross cash sales;

H1  MFA farm operators exhibit entrepreneurial characteristics as described in entrepreneurship literature regardless the size of annual gross cash sales;

H2  MFA farm operators choose to participate in MFA when considering different types of MFA activities depending on the size of annual gross cash sales; and

H3  MFA farms’ financial situation and quality of life have been improved as the results of participating in MFA regardless the size of annual gross cash sales.

Diagram 1: The Structure of the Research

SURVEY DESIGN AND ADMINISTRATION

Two levels of the surveys were designed and distributed in New England for this study. The first level was to design a postcard survey (Appendix 1) to gather information from ALL farmers in New England. This is the first attempt
in the U.S. to use a census approach to study MFA by offering all farmers in New England an opportunity to respond. Using the NASS database and mailing services, the postcard survey was mailed to 33,112 farmers in New England between October 2011 and February 2012. Useable postcards were collected by the University of Vermont. Non-deliverable postcards were returned to the NASS. We received 4,636 useable responses or a 14% return rate.

A detailed farm survey (Appendix 2) was designed, pre-tested, and administered to gather information from farm operators who returned the postcards plus additional random sample units drawn by the NASS New England office. Researchers developed questions following many examples such as agritourism survey in Vermont and Massachusetts between 1998 and 2009, USDA Agricultural Risk Management survey conducted by the Economic Research Services office, and Census of Agriculture surveys. There were four sections in the farm survey and the reference year was 2011. The first section included questions about general profile and operation, status of organic or non-organic operations, if farmers participated in MFA in 2011 and what types, if farmer received government payment, and how farmers connect with other farmers and organizations for advice, training, education, and technical support. The second section gathered financial information regarding estimated sales and expenses in dollars with respect to conventional distribution/sales, direct sales to non-conventional outlets, agritourism activities, and value added productions beyond fresh produce and meat products. The third section includes questions about individual demographics, family/household compositions, and off farm jobs. The last section asked farmers to identify reasons, challenges, entrepreneurial characteristics, and expectations/future outlook as the result of their participation in MFA activities.

The survey was printed at the University of Vermont, and the NASS New England office assisted in mailing all surveys to 7,026 farmers (including 4,636 producers who responded to the postcard survey, plus a random sample of 2,390 producers selected by the NASS staff). The questionnaire was mailed in April 2012 and 1,029 surveys were returned by August 2012 and useable for analysis (15% response rate). This paper used data from the detailed survey only.

DESCRIPTIVE STATISTICS OF RESPONDENTS’ PROFILE

The number of survey respondents from each state in New England matched with the Census of Agriculture farm distribution data very well, which
implied the survey respondents formed a balanced representative sample for our analysis. The demographics of respondents also mirrored what was reported in the 2012 Census of Agriculture (Graph 1, 2, 3). In general, most of the respondents were over 55 year of age and a majority was male. Some respondents indicated a joint ownership with their partners, therefore we had a few in the “male and female category. While the Census of Agriculture provided no information about farmers’ education, over 50 percent of our respondents had at least some college education, and most of them had 4-year college education or above. Looking across categories of annual gross cash sales, more respondents were earning less than $10,000, followed by earning between $10,000 and $100,000. But the demographic distribution was consistent across micro, small, medium, and large farms – majority respondents were male, highly educated, and over 55 years old.

Graph 1: Age Distribution for MFA Farms by Categories of Annual Gross Cash Income

![Graph 1: Age Distribution for MFA Farms by Categories of Annual Gross Cash Income](image-url)
Graph 2: Gender Distribution for MFA Farms by Categories of Annual Gross Cash Income

Graph 3: Education Distribution for MFA Farms by Categories of Annual Gross Cash Income
ARE FARMERS ENTREPRENEURS?

Scholars have discussed and debated definitions of entrepreneur and entrepreneurial characteristics. It would be reasonable to assume that MFA farmers are more innovative than others, since they assume risks, actively seek and create new opportunities with limited resources. We asked the New England farm operators to identify their entrepreneurial characteristics, and interestingly there were no statistically significant differences across size of annual gross cash sales with respect to entrepreneurial characteristics by comparing percentage of responses (Table 3). A slightly higher percentage of the micro farms believed that they were optimistic, not afraid of failure, and creative and innovative. A slightly higher percentage of the small farms seemed to agree that they were confident and enjoyed working with people in general. For medium and large MFA farms, they seemed to be more likely to look before they leap, they tended to plan and consider both negative and positive outcomes, and they were more interested in seeking new opportunities. The only significant differences existed across different types of farms was about taking reasonable risks. A higher percentage of medium sized farms was willing to take reasonable risks, followed by small farms, micro farms, and large farms.
Table 3: Entrepreneurial Characteristics of Respondents by Size of Annual Gross Cash Sales in New England

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<tr>
<th></th>
<th>$1-10000</th>
<th>$10001-100000</th>
<th>$100001-500000</th>
<th>$500000+</th>
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<th>n</th>
<th>% of respondents</th>
<th>N</th>
<th>% of respondents</th>
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<th>% of respondents</th>
</tr>
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<tbody>
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WHY DO FARMERS ENGAGE IN MFA?

Why and how people become entrepreneurial is a mystery. Previous literature found that farmers were interested in sustaining and growing their farm through additional activities to provide jobs for family, and to use existing resources to create additional opportunities that would generate extra value and benefits. Whether it is due to the depression or personal preferences, farm entrepreneurs make decisions to participate in MFA by observing trends or solving problems to improve personal and family well-being. Farming is risky, and taking on more work certainly add stress to farm families. We asked farmers a simple question – why do you participate in MFA? (Table 4) Obviously financial incentive, promoting connections with customers, and seeking diversification seemed to be the most important reasons, especially for large farms. Other reasons such as promoting locally produced products, offering employment to family members, sustaining local farmland, and providing educational channel seemed to be equally important across all sizes of farms. Among all direct sales strategies, respondents seemed to favor direct sales to customers through farm stands, farmers’ markets, and Community Supported Agriculture programs. A higher percentage of micro farms indicated that they chose to participate in agritourism, value added production, and direct sales to

<table>
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<th>I try to be reasonably certain about the situation I face when starting an important activity</th>
<th>n</th>
<th>% of respondents</th>
<th>n</th>
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<th>% of respondents</th>
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Note: * indicates statistically significant at 10%.
consumers because it was their hobby. Access to employer provided health insurance seemed to be very important to all sizes of farms when they decided to obtain off farm jobs. Maybe the situation is different now after the Affordable Care Act is in place.

Table 4: Reasons to Participate in MFA by Categories of Annual Gross Cash Sales in New England

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<thead>
<tr>
<th>Annual Gross Cash Sales</th>
<th>1 - 10000 (n=241)</th>
<th>10001 - 100000 (n=223)</th>
<th>100001 - 500000 (n=113)</th>
<th>500000+ (n=34)</th>
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<td>Increase Revenue through</td>
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<tr>
<td>Agritourism***</td>
<td>9.50%</td>
<td>17.50%</td>
<td>21.20%</td>
<td>35.30%</td>
</tr>
<tr>
<td>Value Added***</td>
<td>12.90%</td>
<td>21.50%</td>
<td>27.40%</td>
<td>44.10%</td>
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<tr>
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<td>36.50%</td>
<td>52.90%</td>
<td>42.50%</td>
<td>52.90%</td>
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<tr>
<td>Sales to Retailers***</td>
<td>13.30%</td>
<td>28.30%</td>
<td>30.10%</td>
<td>38.20%</td>
</tr>
<tr>
<td>Sales to Institutions***</td>
<td>2.50%</td>
<td>7.60%</td>
<td>14.20%</td>
<td>11.80%</td>
</tr>
<tr>
<td>Off farm jobs</td>
<td>16.20%</td>
<td>15.20%</td>
<td>15.00%</td>
<td>14.70%</td>
</tr>
<tr>
<td>Improve Financial Situation through</td>
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<tr>
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<td>4.60%</td>
<td>12.60%</td>
<td>17.70%</td>
<td>29.40%</td>
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<tr>
<td>Value Added***</td>
<td>5.80%</td>
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<td>Sales to Consumers***</td>
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<td>7.50%</td>
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<td>6.70%</td>
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<td>8.80%</td>
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<tr>
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<td>28.60%</td>
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<td>Promote Connections to Consumers through</td>
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<tr>
<td>Sales to Consumers*</td>
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<td>Diversify Farm Operations through</td>
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### Access Employer Provided Health Insurance through Agritourism

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### Promote Local Farm Scenery through Agritourism

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### Enhance Sustainability of Local Farmland through Agritourism

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<tr>
<td></td>
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<td>4.40%</td>
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## Provide Educational Channel through Agritourism*

<table>
<thead>
<tr>
<th></th>
<th>Agritourism</th>
<th>Value Added</th>
<th>Sales to Consumers</th>
<th>Sales to Retailers</th>
<th>Sales to Institutions</th>
<th>Off Farm Jobs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<td>13.50%</td>
<td>23.90%</td>
<td>23.50%</td>
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<td></td>
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<tr>
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<td>5.30%</td>
<td>5.90%</td>
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<td></td>
</tr>
<tr>
<td></td>
<td>14.90%</td>
<td>18.80%</td>
<td>8.00%</td>
<td>11.80%</td>
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<td></td>
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<tr>
<td></td>
<td>4.10%</td>
<td>6.70%</td>
<td>5.30%</td>
<td>5.90%</td>
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<td></td>
</tr>
<tr>
<td></td>
<td>2.90%</td>
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<td>3.50%</td>
<td>5.90%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
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<td>0.90%</td>
<td>2.70%</td>
<td>5.90%</td>
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</tr>
</tbody>
</table>

## Create Different lifestyle for Family through Agritourism

<table>
<thead>
<tr>
<th></th>
<th>Agritourism</th>
<th>Value Added</th>
<th>Sales to Consumers</th>
<th>Sales to Retailers</th>
<th>Sales to Institutions</th>
<th>Off Farm Jobs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>8.30%</td>
<td>8.50%</td>
<td>12.40%</td>
<td>17.60%</td>
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<td></td>
</tr>
<tr>
<td></td>
<td>8.70%</td>
<td>9.90%</td>
<td>7.10%</td>
<td>8.80%</td>
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<td></td>
</tr>
<tr>
<td></td>
<td>17.80%</td>
<td>26.00%</td>
<td>13.30%</td>
<td>17.60%</td>
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<td></td>
</tr>
<tr>
<td></td>
<td>5.40%</td>
<td>10.80%</td>
<td>8.00%</td>
<td>8.80%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1.70%</td>
<td>2.70%</td>
<td>3.50%</td>
<td>2.90%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>4.60%</td>
<td>4.90%</td>
<td>4.40%</td>
<td>5.90%</td>
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<td></td>
</tr>
</tbody>
</table>

## It is My Hobby through Agritourism

<table>
<thead>
<tr>
<th></th>
<th>Agritourism</th>
<th>Value Added*</th>
<th>Sales to Consumers***</th>
<th>Sales to Retailers</th>
<th>Sales to Institutions</th>
<th>Off Farm Jobs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>11.20%</td>
<td>7.20%</td>
<td>6.20%</td>
<td>5.90%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>9.10%</td>
<td>9.40%</td>
<td>1.80%</td>
<td>5.90%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>26.10%</td>
<td>21.50%</td>
<td>3.50%</td>
<td>11.80%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>7.90%</td>
<td>9.00%</td>
<td>0.90%</td>
<td>8.80%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1.20%</td>
<td>1.30%</td>
<td>0.00%</td>
<td>8.80%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>4.10%</td>
<td>4.00%</td>
<td>0.00%</td>
<td>8.80%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: * indicates statistically significant at 10%; ** indicates statistically significant at 1%; and *** indicates statistically significant at 0.1%.
CHALLENGES AND BARRIER OF MFA OPERATIONS IN NEW ENGLAND

Several challenges and issues were cited from the literature such as lack of resources, lack of qualified and reliable employees, competition, technical training, and government tax and other regulations. Scholars also examined family issues, socio-cultural barriers, and structural-economic-environmental barriers (Mohammadbagher, Siami, Khozain, & Nezambabad, 2012; Liang & Dunn, 2013). We asked New England farmers to indicate which barriers if applicable (check all that apply) prohibited their involvement or expansion in MFA. Our survey respondents seemed to agree with most of the issues that were identified in the literature, with some discrepancies across different sizes of farms (Table 5).

For micro farms, access to finance was the most important barrier for them to be engaged in off farm jobs, probably when they intended to start/manage non-agricultural works. Access to land was one of the barriers for micro farmers to be involved in value added production and direct sales. Most of the micro farmers agreed that access to networks and support systems was the bigger problem for them to be involved in MFA. Higher percentage of small farms indicated that access to finance, access to market, access to labor, and access to service providers/vendors were issues for them to be involved in MFA. Interestingly for large farms, access to training and access to service provider/vendors were major issues with respect to value added production.

ARE WE BETTER OFF AS THE RESULTS OF PARTICIPATING IN MFA?

Decisions have consequences! Farmers who choose to participate in MFA shared their honest opinion about consequences and future outlook after they adopted MFA strategies (Table 6). An overwhelmingly higher percentage of respondents, regardless of type of farm, agreed that they would continue participating in MFA. A significantly higher percentage of micro farmers agreed and strongly agreed that MFA indeed improved their family financial situation and quality of life. Many micro farmers were neutral regarding whether their
## Table 5: Challenges for New England MFA Farmers

<table>
<thead>
<tr>
<th>Access to Financing Capital to Gross Farm Income</th>
<th>1 - 10000</th>
<th>10001 - 100000</th>
<th>100001 - 500000</th>
<th>500000+</th>
<th>Total Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agritourism</td>
<td>33.30%</td>
<td>38.90%</td>
<td>20.40%</td>
<td>7.40%</td>
<td>54</td>
</tr>
<tr>
<td>(n=18)</td>
<td>(n=21)</td>
<td>(n=11)</td>
<td>(n=4)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value Added</td>
<td>31.40%</td>
<td>35.30%</td>
<td>25.50%</td>
<td>7.80%</td>
<td>51</td>
</tr>
<tr>
<td>(n=16)</td>
<td>(n=18)</td>
<td>(n=13)</td>
<td>(n=4)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>sales to consumers</td>
<td>38.30%</td>
<td>42.60%</td>
<td>12.80%</td>
<td>6.40%</td>
<td>47</td>
</tr>
<tr>
<td>(n=18)</td>
<td>(n=20)</td>
<td>(n=6)</td>
<td>(n=3)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales to retail</td>
<td>35.30%</td>
<td>47.10%</td>
<td>8.80%</td>
<td>8.80%</td>
<td>34</td>
</tr>
<tr>
<td>(n=12)</td>
<td>(n=16)</td>
<td>(n=3)</td>
<td>(n=3)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>sales to institutions</td>
<td>30.40%</td>
<td>43.50%</td>
<td>17.40%</td>
<td>8.70%</td>
<td>23</td>
</tr>
<tr>
<td>(n=7)</td>
<td>(n=10)</td>
<td>(n=4)</td>
<td>(n=2)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>off-farm jobs/business</td>
<td>60.00%</td>
<td>26.70%</td>
<td>6.70%</td>
<td>6.70%</td>
<td>15</td>
</tr>
<tr>
<td>(n=9)</td>
<td>(n=4)</td>
<td>(n=1)</td>
<td>(n=1)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Access to Land to Gross Farm Income             | 34.80%    | 34.80%         | 13.00%          | 17.40%  | 23               |
| (n=8)                                          | (n=8)     | (n=3)          | (n=4)           |         |                  |
| Value Added                                     | 50.00%    | 22.20%         | 22.20%          | 5.60%   | 18               |
| (n=9)                                          | (n=4)     | (n=4)          | (n=1)           |         |                  |
| sales to consumers                              | 48.70%    | 33.30%         | 15.40%          | 2.60%   | 39               |
| (n=19)                                         | (n=13)    | (n=6)          | (n=1)           |         |                  |
| sales to retail                                 | 39.50%    | 36.80%         | 15.80%          | 7.90%   | 38               |
| (n=15)                                         | (n=14)    | (n=6)          | (n=3)           |         |                  |
| sales to institutions                           | 30.00%    | 40.00%         | 20.00%          | 10.00%  | 20               |
| (n=6)                                          | (n=8)     | (n=4)          | (n=2)           |         |                  |
| off-farm jobs/business                           | 37.50%    | 50.00%         | 12.50%          |         | 8                |
| (n=3)                                          | (n=4)     | (n=1)          | (n=1)           |         |                  |

| Access to Markets and Customers to Gross Farm Income | 30.00%    | 30.00%         | 20.00%          | 20.00%  | 30               |
| (n=9)                                          | (n=9)     | (n=6)          | (n=6)           |         |                  |
| Value Added                                     | 18.50%    | 48.10%         | 18.50%          | 14.80%  | 27               |
| (n=5)                                          | (n=13)    | (n=5)          | (n=4)           |         |                  |
| sales to consumers                              | 35.30%    | 41.20%         | 15.70%          | 7.80%   | 51               |
| (n=18)                                         | (n=21)    | (n=8)          | (n=4)           |         |                  |
| sales to retail                                 | 28.10%    | 40.60%         | 15.60%          | 15.60%  | 32               |
| (n=9)                                          | (n=13)    | (n=5)          | (n=5)           |         |                  |
| sales to institutions                           | 38.10%    | 33.30%         | 23.80%          | 4.80%   | 21               |
| (n=8)                                          | (n=7)     | (n=5)          | (n=1)           |         |                  |
| off-farm jobs/business                           | 33.33%    | 66.67%         |                 |         | 9                |
| (n=3)                                          | (n=6)     |               |                 |         |                  |

| Access to Labor to Gross Farm Income             | 33.30%    | 28.20%         | 28.20%          | 10.30%  | 39               |
| (n=13)                                         | (n=11)    | (n=11)         | (n=4)           |         |                  |
| Value Added                                     | 33.30%    | 33.30%         | 25.00%          | 8.30%   | 48               |
| (n=16)                                         | (n=16)    | (n=12)         | (n=4)           |         |                  |
| sales to consumers                              | 32.90%    | 43.80%         | 16.40%          | 6.80%   | 73               |
| (n=24)                                         | (n=32)    | (n=12)         | (n=5)           |         |                  |
family had a more positive outlook for their farming future as the results of MFA. The future outlook of these micro family farms probably related more to the overall assessment of economic volatility, and uncertainty of family members’ future decisions whether young people will stay in farming. For small, medium, and large size farms, our respondents seemed to be very positive about the impacts of MFA on their family financial situation, quality of life, and future outlook of farming. As discussed in previous studies, most small business owners believed that their family members would support them in the new venture creation process if they would start another new venture in the future (Liang & Dunn, 2009; Liang & Dunn, 2013).

<table>
<thead>
<tr>
<th>Access to networks and Support Systems to Gross Farm Income</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agritourism</td>
<td>50.00% (n=13)</td>
</tr>
<tr>
<td></td>
<td>26.90% (n=7)</td>
</tr>
<tr>
<td></td>
<td>11.50% (n=3)</td>
</tr>
<tr>
<td></td>
<td>11.50% (n=3)</td>
</tr>
<tr>
<td></td>
<td>26</td>
</tr>
<tr>
<td>value added</td>
<td>31.60% (n=6)</td>
</tr>
<tr>
<td></td>
<td>15.80% (n=3)</td>
</tr>
<tr>
<td></td>
<td>21.10% (n=4)</td>
</tr>
<tr>
<td></td>
<td>31.60% (n=6)</td>
</tr>
<tr>
<td></td>
<td>19</td>
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<tr>
<td>sales to consumers</td>
<td>57.10% (n=16)</td>
</tr>
<tr>
<td></td>
<td>25.00% (n=7)</td>
</tr>
<tr>
<td></td>
<td>10.70% (n=3)</td>
</tr>
<tr>
<td></td>
<td>7.10% (n=2)</td>
</tr>
<tr>
<td></td>
<td>28</td>
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<tr>
<td>sales to retail</td>
<td>51.90% (n=14)</td>
</tr>
<tr>
<td></td>
<td>33.30% (n=9)</td>
</tr>
<tr>
<td></td>
<td>7.40% (n=2)</td>
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<td></td>
<td>7.40% (n=2)</td>
</tr>
<tr>
<td></td>
<td>27</td>
</tr>
<tr>
<td>sales to institutions</td>
<td>54.50% (n=12)</td>
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<td></td>
<td>31.82% (n=7)</td>
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<tr>
<td></td>
<td>9.09% (n=2)</td>
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<td></td>
<td>4.55% (n=1)</td>
</tr>
<tr>
<td></td>
<td>22</td>
</tr>
<tr>
<td>off-farm jobs/business</td>
<td>50.00% (n=3)</td>
</tr>
<tr>
<td></td>
<td>33.30% (n=2)</td>
</tr>
<tr>
<td></td>
<td>16.70% (n=1)</td>
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Table 6: Selected Outcomes for the New England MFA Farms

<table>
<thead>
<tr>
<th>My family's financial situation has been improved**</th>
<th>$1-10000</th>
<th>$10001-100000</th>
<th>$100001-500000</th>
<th>$500000+</th>
</tr>
</thead>
<tbody>
<tr>
<td>n</td>
<td>% of respondents</td>
<td>n</td>
<td>% of respondents</td>
<td>n</td>
</tr>
<tr>
<td>Strongly Agree</td>
<td>38</td>
<td>18</td>
<td>62</td>
<td>32</td>
</tr>
<tr>
<td>Agree</td>
<td>48</td>
<td>23</td>
<td>58</td>
<td>30</td>
</tr>
<tr>
<td>Neutral</td>
<td>69</td>
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<td>25</td>
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<td>Disagree</td>
<td>31</td>
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<td>9</td>
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<tr>
<td>Strongly Disagree</td>
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<td>100</td>
<td>100</td>
<td>100</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>My family's quality of life has been improved*</th>
<th>$1-10000</th>
<th>$10001-100000</th>
<th>$100001-500000</th>
<th>$500000+</th>
</tr>
</thead>
<tbody>
<tr>
<td>n</td>
<td>% of respondents</td>
<td>n</td>
<td>% of respondents</td>
<td>n</td>
</tr>
<tr>
<td>Strongly Agree</td>
<td>72</td>
<td>34</td>
<td>75</td>
<td>38</td>
</tr>
<tr>
<td>Agree</td>
<td>82</td>
<td>38</td>
<td>63</td>
<td>32</td>
</tr>
<tr>
<td>Neutral</td>
<td>40</td>
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<td>19</td>
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<tr>
<td>Disagree</td>
<td>10</td>
<td>5</td>
<td>13</td>
<td>7</td>
</tr>
<tr>
<td>Strongly Disagree</td>
<td>9</td>
<td>4</td>
<td>6</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
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<td>100</td>
<td>100</td>
<td>100</td>
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</table>

<table>
<thead>
<tr>
<th>My family has a more positive outlook for our farming operations</th>
<th>$1-10000</th>
<th>$10001-100000</th>
<th>$100001-500000</th>
<th>$500000+</th>
</tr>
</thead>
<tbody>
<tr>
<td>n</td>
<td>% of respondents</td>
<td>n</td>
<td>% of respondents</td>
<td>n</td>
</tr>
<tr>
<td>Strongly Agree</td>
<td>28</td>
<td>14</td>
<td>24</td>
<td>13</td>
</tr>
<tr>
<td>Agree</td>
<td>47</td>
<td>23</td>
<td>58</td>
<td>30</td>
</tr>
<tr>
<td>Neutral</td>
<td>80</td>
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<td>33</td>
</tr>
<tr>
<td>Disagree</td>
<td>38</td>
<td>19</td>
<td>36</td>
<td>19</td>
</tr>
<tr>
<td>Strongly Disagree</td>
<td>11</td>
<td>5</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Total</td>
<td>200</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>I would continue participating in multifunctional</th>
<th>$1-10000</th>
<th>$10001-100000</th>
<th>$100001-500000</th>
<th>$500000+</th>
</tr>
</thead>
<tbody>
<tr>
<td>n</td>
<td>% of respondents</td>
<td>n</td>
<td>% of respondents</td>
<td>n</td>
</tr>
</tbody>
</table>

Note: * indicates statistically significant at 10%; ** indicates statistically significant at 1%; and *** indicates statistically significant at 0.1%.
CONCLUSIONS AND IMPLICATIONS

Individuals can and will develop entrepreneurial skills and experiences when circumstances provoke them. Globally researchers agree that people who are driven by their own desire and accumulated experiences, supported by family/friends and organizations, and recognized by their reputation and contribution are more likely to become successful entrepreneurs (Pissarides, Singer, & Svejnar, 2003; Cetindamar, 2005; Bewayo, 1995; Niazkr & Arab-Moghaddam, 2011). Our first hypothesis was supported by the survey results that most of the farmers who participated in our study, regardless of the size of sales, shared similar entrepreneurial characteristics as described in literature – being optimistic, realistic, creative, innovative, confident, and open minded to opportunities. There was a significant difference with respect to taking reasonable risks across four types of farms. Large farmers tended to be more realistic and more conservative in planning and seeking new opportunities. It makes sense for different sizes of farms to consider different intensity of capital investment, resource allocation, organizational structure, and management and marketing strategies when engaging in MFA. It would imply more complex decision making process for large commercial farms compared to micro, small, and medium sized farms.

Literature has never discussed why farmers decided to engage in MFA, and how MFA influenced farming orientations and future outlook for farm households. According to the Census of Agriculture and the USDA ERS Resource Management Survey (USDA, 2009; USDA 2012), the net increase in the number of family farms was more than 100,000 since 2005. Over 50 percent of these family farms earn less than $10,000 in annual gross cash sales. What triggered more people to go into farming? The survey results supported our second hypothesis that MFA farm operators chose to participate in MFA when considering different types of MFA activities depending on the size of annual gross cash sales. Micro and small farms in our study chose to participate in various MFA activities for different reasons compared to medium and large size farms. Given a steadily growing aging trend among farm operators, micro and small farms have more serious concerns about their farming future. Many survey respondents, particularly micro and small farms, chose to use direct sales to connect with customers because farmers would like to promote consumers’ awareness about local foods, offer educational channel for general public about farming and origin of food, enhance sustainability of local farmland, and connect
with other organizations in the community. Nor surprisingly many micro and small farms were hobby farms or lifestyle farms, and these would likely be noncommercial family farms as defined by the USDA. Large commercial farms, on the other hand, preferred to use value added production to diversify farming activities and to increase revenue.

In our survey, the MFA farms share the same passion and the same concerns as entrepreneurs in other industries. The survey results supported our third hypothesis that MFA farms’ financial situation and quality of life had been improved as the results of participating in MFA regardless the size of annual gross cash sales. Micro farmers had to cross more hurdles than other sizes of farms in our survey. A higher percentage of micro farms revealed challenges in accessing resources such as capital, land, qualified labor, technical support, and networks no matter what types of the MFA they chose to establish. Small farms engaged in direct sales had more issues to acquire capital, market, and customers. Large commercial farms needed more technical training when they decided to participate in value added production. Many farmers offered additional comments when they returned surveys. Many shared comments about future generation lacking interests and skills to continue farming activities, and they would not recommend their own children to go into farming. Agricultural operations cannot be controlled or managed when dealing with weather issues, climate change, and natural disasters. Farmers rely on experience and history to operate and manage the best they can, given a set of parameters over which they have no control. Many farmers prefer their children to get steady jobs outside farming first, then maybe the children can stay in agriculture once they have income security.

Most of the respondents were still very excited, optimistic, and committed to the future of farming and the development of MFA. A majority respondents believed that MFA indeed improved their financial situation and quality of life. Micro farmers were not as sure if participating in MFA actually made any difference in their financial situation. Micro farmers were also more reserved in future outlook with respect to MFA. In general, a significant proportion of our survey respondents would continue participating in MFA in the future. Several survey respondents commented on why they would like to adopt the MFA, for example:

“I had a full time job and I am still a farmer. It is a great way to build my retirement life style to be a farmer.”
“Our farm is a farm, but we focus more on teaching people how to grow certain things. We want to educate others and help other farmers to succeed.”

“I want to work with other farmers to build a stronger network for farmers to link with other people and organizations in our community. Our farm is very small, but we have a bigger vision to contribute to our community.”

“We do not sell much of our farm products. But our farm offers seed and pollination services to others. We also give away compost to others. Our services count more than farm income.”

The spirit of the MFA is beyond applying innovative strategies for diversification or profit maximization. Farmers, large or small, offer intangible assets to our society. The working landscape and sustainable ecology significantly contribute to the improvement of quality of life and community health for all. Much information in existing literature has talked about entrepreneurs’ achievement in society (Swierczek & Thai, 2003; Benzing, Chu, & Callanan, 2005; Benzing & Chu, 2005; Pistrui, Huang, Oksoy, Zhao, & Welsch, 2001; Ozsoy, Oksoy, & Kozan, 2001; Bewayo, 1995; Cetindamar, 2005). The MFA farmers in our study set balanced goals to reach for personal satisfaction and growth, creating opportunities to support family members and others, and making direct positive impacts to communities. It seems that more people are entrepreneurial and enthusiastic about farming and engaging in MFA, which could lead to a promising and prosperous future in agriculture in the U.S. This has a strong implication in policy formation to support farmers who are engaged in or interested in MFA. The USDA recently introduced a program, Know Your Farmer, Know Your Food (Image 1), to promote local food movement and to help producers to connect with consumers. Farmers’ Market Programs and Farm-to-School Programs are only two examples of federal initiatives in the local food campaign. However there is still a very large gap between Federal initiatives and state and local legislation to help small farmers. Many issues around regulations, taxation, and legitimacy of practicing/establishing MFA still need to be defined and polished for small farmers to follow.

We also encourage our entrepreneurship and small business colleagues to include, where possible, small farmers in their research. It will be beneficial to both agricultural and non-agricultural audiences to learn from multiple aspects by bridging science-based knowledge and information from theories and
practices generated by entrepreneurship, social studies, economics, environmental sciences, and ecological analysis scholars.

Image 1. USDA Know Your Farmer Know Your Food Website
RFARMER

REFERENCES


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\[\text{\textsuperscript{i}}\] The U. S. Small Business Administration defines small businesses as enterprises with fewer than 500 full time equivalent employees.

\[\text{\textsuperscript{ii}}\] The U.S. Department of Agriculture conducts the Census of Agriculture every 5 years.

\[\text{\textsuperscript{iii}}\] USDA defines small farms as any commercial or non-commercial farm earning less than $250,000 in annual gross cash sales. Farms earning more than $250,000 in annual gross cash sales are large farms. \[\text{http://www.extension.org/pages/13823/usda-small-farm-definitions#.U776GUDyRpk}\]

\[\text{\textsuperscript{iv}}\] The MFA definition for our study is different from the Census of Agriculture. The Census of Agriculture offers general descriptions for agritourism, value added, and direct sales. In our study, agritourism refers to outdoor recreation, educational tourism, accommodations and food services, and entertainment, festival, and other events. Value added includes jam, jelly, other fruit preserved products, processed dairy products, pickled fruit and vegetables, wine, wool and mohair products, process maple products, candy, cream, spice, flour, sugar, other baking and cooking condiments, aquaculture, and forest products and by-products. Direct sales relate to cooperative and other contracted sales, community supported agriculture, pick your own, farm stand, farmers’ market, Christmas tree, firewood, hay, greenhouse and nursery products, local institutions such as hospitals, schools, or correctional facilities, restaurants and local retail outlets, national retail franchise, and other types of open market sales.

\[\text{\textsuperscript{v}}\] Hurricane Irene hit New England region during our postcard mailing period, which could significantly influence response rate and farmers’ perceptions in operation, management, and future outlook.
Accelerating Collegiate Entrepreneurship (ACE): The Architecture of a University Entrepreneurial Ecosystem Encompassing an Intercollegiate Venture Experience

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ABSTRACT

It is well documented that small/medium enterprises directly employ over 50% of the U.S. workforce and are responsible for significant innovations and disruptive technologies. Many universities have developed entrepreneurship educational programs, as well as, intra/inter university business plan competitions. This paper posits that the architecture of university educational programs must (1) frame a complete educational ecosystem; (2) be guided by important theoretical tenets regarding entrepreneurial characteristics and behavior and (3) provide a real time entrepreneurial start-up experience that links business students with other university students; external business mentors; and the venture capital community. Our paper is comprised of three sections: (1) a discussion of the current apparatus of entrepreneurship programs; (2) the integration of business plan competitions into the current entrepreneurship constructs; (3) a proposal and review of a new pedagogical construct, Accelerating Collegiate Entrepreneurship (ACE); and a discussion of the implications and the potential for the adaptation of this structure based on its implementation at a US university.

INTRODUCTION

Entrepreneurial activity is a type of planned behavior for which intention models are ideally suited (Krueger Jr, Reilly, and Carsrud 2000). There are two primary intention-based models used to predict entrepreneurial intent (EI). The
first is the theory of planned behavior (Ajzen 1991), which is based on perceptions of personal attractiveness, social norms, and feasibility. The second is the model of the entrepreneurial event (Shapero 1982b), which argues that entrepreneurial activity depends on perception of personal desirability, feasibility, and propensity to act. Work by Kreuger supports the predictive capability of these models on EI, and slightly favors the Shapero model (Krueger Jr, Reilly, and Carsrud 2000). Neither of these models finds that individual factors, such as demographics, have a strong effect on predicting EI, but do find such factors useful in identifying boundaries that define different groups within a population. Shapero found that some groups produce more entrepreneurial events than others (Shapero 1982b). Florin (Florin, Karri, and Rossiter 2007) further explore the basis of the entrepreneurial drive (ED), which they posit as being made up of five personal traits, including preference for innovation, nonconformity, proactive disposition, self-efficacy, and achievement motivation, all of which have some representation in both Shapero’s model and the theory of planned behavior model. According to Shapero, the most obvious entrepreneurial event is the formation of a new company, and strong intention to start a business should result in an eventual attempt.

From the perspective of economics, an entrepreneur starting a successful company benefits the local community in terms of job creation and business growth (Chatterji, Glaeser, and Kerr 2013, Delgado, Porter, and Stern 2010, Glaeser, Kerr, and Ponzetto 2010, Kerr 2013). As a result, governments and private organizations focused on economic development have been increasingly interested in fueling entrepreneurial activity (Schramm 2006). While there is a high risk of failure involved in new entrepreneurial businesses, especially technology-based ventures, entrepreneurs can earn large returns and continuously expand their wealth if successful (De Nardi, Doctor, and Krane 2007). A 1999 study showed that the three countries with the highest levels of entrepreneurial activity also enjoyed the highest average growth in gross domestic product and the highest levels of employment (Hardy 1999). Economists believe that entrepreneurial activity is critical to economic progress because entrepreneurs create new businesses, and in turn new businesses create new jobs (Drucker 1999, Malecki 1997, Nijkamp 2003, Quadrini 2000).

From a university standpoint, the eventual attempt and (hopeful) success of entrepreneurs is a measure of the impact universities can have on entrepreneurial education (Galloway and Brown 2002) and ultimately on economic growth. As universities undertake the national challenge to broaden
their entrepreneurial impact, a transformation is underway that is challenging the traditional academic models of entrepreneurial education (Navarro 2008).

Given the potential impact of university entrepreneurship programming on the development of new businesses and the creation of jobs, the educational architecture regarding entrepreneurship merits a timely review. Our paper is comprised of three sections: (1) a discussion of the current apparatus of entrepreneurship programs; (2) the integration of business plan competitions into the current entrepreneurship constructs; (3) a proposal and review of a new pedagogical construct, Accelerating Collegiate Entrepreneurship (ACE); and a discussion of the implications and the potential for the adaptation of this structure at a US university.

LITERATURE REVIEW

(1) Entrepreneurship Education in the US

Entrepreneurship education has broadened significantly during the past thirty years, and has become one of the fastest growing subjects in the undergraduate curriculum (Béchard and Grégoire 2005, Fayolle, Gailly, and Lassas-Clerc 2006, Henry, Hill, and Leitch 2005, Katz 2003, Kirby 2004, Kuratko 2005, Matlay 2008, McMullan and Long 1987, Oosterbeek, van Praag, and Ijsselstein 2010, Pittaway and Cope 2007, Solomon 2007). Almost thirty years ago, (Vesper and McMullan 1988) helped differentiate the education of entrepreneurs with those of management by offering the challenge of entrepreneurship education to “generate more quickly a greater variety of different ideas for how to exploit a business opportunity, and the ability to project a more extensive sequence of actions for entering a business.” This challenge encompasses the broad spectrum of the generation of ideas to the commercialization of innovation. “Though entrepreneurship can involve – and thus often is mistaken for- invention, creativity, management, starting a small business, or becoming self-employed, it is neither identical with nor reducible to any of them” (Kauffman 2009a)

According to the Kaufman Foundation in their recent report “Entrepreneurship in American Higher Education” (2009a) a number of conclusions were drawn regarding the status of entrepreneurship education, of which the most relevant is that a single approach to entrepreneurship education is both “unrealistic and unauthentic” (2009a, p3). The report suggests that
entrepreneurship education should be specific to the culture and climate of the university and its local community.

Various perspectives offered in the literature claim entrepreneurship andragogy is driven by a number of influences, including student demand for creativity and innovation (Solomon 2007), the academe’s requirement of academic rigor (Plaschka and Welsch 1990), management’s skill development in leadership, business’ perception of trends and markets (Shepherd, Douglas, and Shanley 2000) and precondition of an integrative curriculum to include negotiation, finance, marketing, technology and new product development (Charney and Libecap 2000, Vesper and McMullan 1988). Numerous studies and researchers have generated a list of course demands to fulfill the needs identified as the challenges associated with each step of venture development (Plaschka and Welsch 1990, Solomon 2007, Vesper and McMullan 1988). For all practical purposes, entrepreneurship programs seem to have evolved not just from the realm of commerce but from the understanding of the cultural, social and economic values and policies of our society (Kauffman 2009a). Therefore, the programs in universities must reflect the financial, philosophical and community resources in which they preside.

In the field of entrepreneurship it is commonly mentioned that past experience plays a significant role in the decision making-process of entrepreneurs (Minniti and Bygrave 2001, Sarasvathy 2001). If one considers the importance of past experience in the success of new business ventures, it is easy to understand why financiers typically look for an experienced (and previously successful) management team. From the academic perspective, researchers have suggested that the experiential learning aspect must be included in any successful entrepreneurial program (Krueger 2007, Solomon, Duffy and Taarabishy 2002, Zeithaml and Rice 1987). The literature goes further to suggest that concrete experiences are necessary to create successful entrepreneurs (Cromie and Donoghue 1992). Some have proposed simulation as a way to accelerate the experience within an academic environment while others suggest that reality-based experiential andragogy is necessary for truly training entrepreneurs (Plaschka and Welsch 1990, Hannon 2005). While traditional university models have pushed for the analytic, classroom type of entrepreneurship program, proponents of entrepreneurial activity complain that this former model does little to translate into the “street smarts” necessary to actually be successful entrepreneurs (Gartner and Vesper 1994).
Though writing a business plan is the most highly recommended activity given to entrepreneurs interested in business start-up, and is prevalent in university education (Navarro 2008), the development and use of business plan documents has been a questioned activity in business planning of start-ups in the United States for decades (SBA 2008, Brinckmann, Grichnik, and Kapsa 2010, Honig 2004, Karlsson and Honig 2009, Lange et al. 2009). In a recent book, Tjan et al (2013) found that 70% of companies with successful exits via sale, merger, or IPO, never had a business plan to begin with. Adding to the debate on whether business plans are a significant activity in the start-up process of enterprise development, the SBA (2008) found that only 48 percent of nascent entrepreneurs identified the activity of writing a business plan as an important start-up activity.

When companies such as Microsoft, Dell Computers, Rolling Stone Magazine, and Calvin Klein all started without business plans or competitions, the question becomes “do business plans effect the success of an enterprise, and if not, then what value do business plan competitions generate (Karlsson and Honig 2009)?” A study conducted by Babson College of 117 ventures concluded that unless a nascent entrepreneur needs to raise substantial start-up capital from institutional investors or business angels, they found no compelling reason to write a business plan (Kirsch, Goldfarb, and Gera 2009).

Honig (2004) found that entrepreneurs write business plans much like a right of passage, a symbolic act to gain legitimacy, and was purely to gain external capital. In fact, he found that sometimes writing a formal business plan had a negative consequence when the entrepreneur often followed a mimic strategy, unsuccessfully copying the path of other firms. While we often assume that VC companies and banks were the source of pressure for methodical and painstaking business plans, it turns out that business schools were the source of normative pressure to write a business plan (Karlsson and Honig 2009).

The literature on business plan education is based on presumptions of the local business environment rather than on empirically supported and effective business practices (Karlsson and Honig 2009). In fact, in a comparison on content in a sample of entrepreneurship textbooks to start-up activities practiced by nascent entrepreneurs (Edelman, Manolova, and Brush 2008), there appears to be a disconnect in over 40 percent of the start-up activities. In other words, there are groups of activities significantly more emphasized by textbooks in comparison to practice. The impetus to academics is thus to determine how entrepreneurship education can focus on actions rather than plan writing.
(Timmons and Spinelli 2007). While entrepreneurs do not emphasize business planning as much as textbooks, 78 of the top 100 universities identified by the US News and World Report (2004) offered courses related to business plan development and considered it as the most important feature of their entrepreneurship education provision (Matlay 2008).

Business plans may help the entrepreneur make informed calculations about the viability of the new enterprise in the market, and it is estimated that approximately 10 million business plans are written each year world-wide (Karlsson and Honig 2009, 2007). Yet only a minority of entrepreneurs, including MBAs from a preeminent business school in this country, started their venture with a written business plan (Lange et al. 2007). If business plans and their respective competitions are not a major contributor to start-ups and their successes, then we must revisit their role in entrepreneurial education and the purported value their competitions provide, or at least temper our enthusiasm for the level of impact we think they are having. At a minimum, we must reevaluate the way they are integrated into the entrepreneurship curriculum.

(2) The Business Plan Competition as a Critical Element in Entrepreneurship Education

Historically, surveys of academic programs showed that the most common elements in entrepreneurship courses were business plan writing, case studies, readings and lectures by guest speakers and faculty (Florin, Karri, and Rossiter 2007, Navarro 2008, Souitaris, Zerbinati, and Al-Laham 2007, Vesper and Gartner 1997). More recently, business plan competitions have gained popularity as a quintessential element of the academic entrepreneurial environment (Der Foo, Kam Wong, and Ong 2005, Honig 2004, Karlsson and Honig 2009, Russell, Atchison, and Brooks 2008). In 2006, the Kaufman Foundation surveyed 2100 universities and found over 330 were offering business plan competitions, with millions of dollars in prizes and services awarded to the winners. The proliferation of these competitions goes beyond entrepreneurship andragogy and the continuing popularity of, and surge in entrepreneurship programs. It is a result of the changing university environment often termed, academic capitalism (Rhoads and Slaughter 2006).

The addition of business plan competitions to the academic entrepreneurship curriculum may be viewed as the beginning of a concerted effort to create a more expansive university entrepreneurship ecosystem that
would result in the creation and success of start-up enterprises. The objective of most competitions is to present a pitch to a panel of investors and venture capitalists, under the assumption that these potential funding sources directly impact enterprise development (Der Foo, Kam Wong, and Ong 2005, Navarro 2008). However, venture capital participated in funding less than 1% of small businesses in the US in 2008 (SBA 2008), accounting for fewer than 2000 firms nationwide. Informal financial support for nascent enterprises was up to 86 times greater than venture capital support for start-ups (SBA 2008), and up to 15 times greater for young companies (Shane and Scott 2009).

However, the measure of success in most business plan competitions is not in how many start-ups are launched and what contributions these start-ups have made to the local economy. Bill Aulet of MIT stated “Don’t judge the success of business plan competitions by how many ventures are actually started” (GCEC, 2009). Rather, there are nascent educational expectations associated with university programs and business plan competitions, especially at the undergraduate level, that are geared towards understanding what investors are looking for in a deal; learning to pitch a deal; and learning to answer investor questions in a real time environment. The primary educational objective in business plan competitions is skill-building that may impact the future development of enterprises. The business plan competition is therefore not necessarily formulated for actual venture start-up. These educational experiences are all drivers of entrepreneurial intent, both through perceived self-efficacy and applied learning. From Piaget’s perspective, we would consider these concrete operational learning experiences aimed at “unlocking the inner entrepreneur” in our students (Piaget and Inhelder 2013). The objective of this carefully crafted educational structure is to develop the students awareness of their capabilities, mature their skill set and recognize their comforts/discomforts with the entrepreneurial process.

The actual start up itself and its impact on the local economy has not been the primary objective of business plan competitions, and that is not necessarily a negative outcome. However, the student perception that the business plan competition (or elevator pitch competition, etc.) is purely an academic exercise may lessen the impact these highly publicized events have on influencing entrepreneurial intent. A Kauffman report on the impact of MIT start-ups highlighted the significant impact MIT entrepreneurs have had on the Boston and Massachusetts economy, most of whom did not participate in a business plan competition (Kauffman 2009a) rather these entrepreneurs emerged from an
entrepreneurial ecosystem composed of elements that organically led to enterprise start-up.

(3) Developing the ACE Model

The University of Texas at San Antonio (UTSA) is new to the realm of entrepreneurship education. As a federally recognized Hispanic Serving Institution (Tjan, Harrington, and Hsieh) with a significant portion of the students being first generation college students and/or non-traditional students, establishing a successful entrepreneurial program was seen as critical to the university and the economic development of the region.

First, we based our ecosystem design on preeminent research in the field of entrepreneurship. Second, UTSA developed a theoretical framework and implemented it as the Accelerating Collegiate Entrepreneurship model (the ACE model). Thirdly, we viewed technology entrepreneurship as a cornerstone to elevating the quality of entrepreneurial education and the potential for economic impact on the geographic region; therefore, new curricula was developed; student teams across colleges were linked; and the venture experience competition was launched.

Research has found that the economic impact of high-tech entrepreneurship is much stronger than the balance of private sector entrepreneurship (Hathaway 2012, Preto, Baptista, and Lima 2009). The high-tech sector is defined as industries with a high share of employees from STEM fields. (Hathaway 2013). As Hathaway (2012) points out, “Since the bottom of the dot-com bust was reached in early 2004, employment growth in high-tech industries outpaced employment growth in the entire private sector by a ratio of three-to-one.” These jobs also earn higher wages compared to workers in other sectors (Hathaway 2012). This creates a multiplier effect – the creation of each high-tech job is associated with the creation of four additional jobs in the local economy – that is three times larger than the multiplier effect for manufacturing jobs. Reference

The Global Entrepreneurship Monitor 2011 report estimates that, across the globe, 63 million young entrepreneurs each expect to hire at least five employees over the next five years (Kelley, Singer, and Herrington 2012). Increasing the number of these types of entrepreneurs should be linked to increased profits, wealth creation, and economic growth (Luke, Verreynne, and Kearins 2007). Moreover, studies indicate that, beyond increased productivity,
entrepreneurial thinking and behavior can help create competitive advantages via business differentiation (Hitt et al. 2001). Other benefits of technology entrepreneurship thinking include the introduction of innovative new products and services in the market that creates greater value for the consumers, or creates new markets entirely (Kelley, Singer, and Herrington 2012).

For largely minority communities, the traditional model for job growth has been to provide education and training with the goal of working for others. Ironically, according to Fairlie (2013), the entrepreneurship rates of Latinos are higher than non-Latino whites but are rarely targeted for entrepreneurship programs and therefore have low Latino participation rates. The ACE model maps into the measurable entrepreneurial spirit of the local/regional community composed of a substantial Latino population, and provides the tools, processes, and facilities to foster the growth of new technology-based entrepreneurs, products, and companies that are sources of job creation and wealth realization for the community and the country.

The infrastructure necessary for developing innovation from students, and to support the development of small businesses especially by student entrepreneurs is what Moore termed as the business ecosystem (Moore 1993). Moore’s concept was simple: [I]nnovative businesses can’t evolve in a vacuum. They must attract resources of all sorts, drawing in capital, partners, suppliers, and customers to create cooperative networks. (Ibid, p. 75). To truly understand the impact we can have on the next generation of entrepreneurs we linked the theory of entrepreneurial intent to the student academic curricula and related activities. In this way critical pressure points of the entrepreneurial ecosystem were identified, as we developed the scheme of the system.

The next phase of the development of the ACE was the identification of courses and activities that incorporated the concept of entrepreneurial intent. The decision to become an entrepreneur has been described as a voluntary and conscious decision (Krueger and Carsrud 1993). The entrepreneurial intent is defined as a state of mind directing a person's attention and action towards self-employment as opposed to organizational employment based on the work of Bird (1988). The intention of carrying out entrepreneurial behaviors may be affected by several factors, such as needs, values, wants, habits, and beliefs (Ajzen 1987, Lee et al. 2004).

We examined both Shapero’s model of the Entrepreneurial Event (Audet), and the theory of planned behavior (TPB) as a starting point for UTSA’s educational framework (Ajzen 1991, Shapero 1982a). While both have
similar antecedents to entrepreneurial intent, we used the empirical work of Krueger (2000) to select Shapero’s model as the basis for our andragogy efforts. Shapero argues that entrepreneurial intent depends on perceptions of personal desirability, feasibility, and propensity to act. We modified Shapero’s model by looking at the work of (Lüthje and Franke 2003) that includes personality traits and contextual factors as antecedents to entrepreneurial intent. The combination of these two models establishes the basis of a new framework. To complete the framework, we propose the addition of three elements that are within the purview of the university’s role, and a final element, cultural factors, that are exogenous to the university environment. We believe that establishing an understanding of the entrepreneurial intent model from this point of view is much more complete for higher education, and have coined it the “ACE” model, which stands for the “Accelerating Collegiate Entrepreneurship” model, as shown in figure 1.

Figure 1 - ACE Model : A Model for Accelerating Collegiate Entrepreneurship
The university-centric elements in the ACE model cover three specific areas, and each are proposed to affect antecedents to entrepreneurial intent. Specifically we propose that the andragogical elements associated with the university’s role in the ACE model affect the expected outcomes, the perceived self-efficacy, and the perceived support. Expected outcomes are enhanced by historical education, case studies, and guest speakers who have the ability to help students associate the potential of entrepreneurial endeavors with concrete examples. Perceived self-efficacy will be enabled through core skill building and experiential learning, involving traditional discipline-based class work, entrepreneurial skill building, and experiential learning, which may also be called applied entrepreneurship. Finally, perceived support will be improved through the addition of mentoring and incubation, either of which may include the addition of supporting professional services and access to capital networks that help entrepreneurs build and launch new ventures.

Pragmatics of using the ACE model

In formulating the new paradigm for entrepreneurship education via the ACE model, we concluded that a final element needed to be embedded in the model in order to bring internal consistency and closure to the entrepreneurial ecosystem. A business plan competition that is a purely academic endeavor with no real product development effort would not provide theoretical and model continuity. An analysis of our own business plan projects showed that most were an academic exercise by business students. Furthermore, our engineering students were producing a stream of technologies that were prototyped and tested as an academic exercise for grade with no translation into product. For our university, this problem became the opportunity space we needed for infusing the ACE model by creating a technology venture start up competition – much more than a business plan competition. We actively engaged in capitalizing on the existing two programs in business and engineering to do five things, namely:

1) Bring an applied entrepreneurial context to the classes;
2) Enable intercollegiate experiential learning;
3) Resource the teams to build proof of principle technology products;
4) Support the teams through a venture competition and launch; and
5) Scientifically study the process to improve entrepreneurial programs and policies at the university.
The first two elements of the process were focused on improving the expected outcomes and perceived self-efficacy of the students, while the third and fourth were geared towards the contextual factors in the ACE model.

**The Technology Entrepreneurship Context**

Unlike many universities that attempt to drive entrepreneurship by the launch of new classes and programs, we focused on bringing the technology entrepreneurship context into existing classes. By pairing seniors in engineering and business, our goal was to bring a new level of intercollegiate entrepreneurial thinking to the university and to create the final element in the entrepreneurial ecosystem. The engineering students in senior design would typically design, build, test, and dispose of a technology or product, get a grade, then get a job. The business students would typically develop a paper business plan (or concept), present it, dispose of it, get a grade, and get a job. While certainly there was academic value in the basic skills the students developed as part of their classes, we felt the need to expand their minds through the applied entrepreneurial context of their work. By teaming the students, such that the business students would build a business plan for the technology being built in engineering, we introduced cross-disciplinary teamwork into their education, and set the stage for an extracurricular tech venture start-up competition.

As part of this process, UTSA created the $100K Student Technology Venture Competition, an extracurricular event offered twice a year to the teams of undergraduate business and engineering students. The intent of this competition was to push the boundaries of traditional business plan competitions by requiring that the proof of principle technology be built and tested by the interdisciplinary team, and presented to judges at an end of semester competition. The competition includes external reviews of business plans by disciplinary experts (legal, financial, entrepreneurial, investor, etc.), a formal technology demonstration event much like a trade show expo in the morning, and an investor pitch in the afternoon. For many of the students, these three stages of the competition provided their first ever hands-on entrepreneurial experiences.

**Intercollegiate Experiential Learning**

While universities remain highly segregated in their colleges and departments, the economy consists of highly multi-disciplinary organizations. By enabling two colleges to coordinate the educational experiences of their senior students, we introduced experiential learning into the process. The business
students had to expand their thinking from small business and lifestyle companies into the broader horizon of technology start-ups and high value growth companies that could impact the regional technology-based economy. The engineering students had to expand their thinking into the realm of value propositions, customer needs, product pricing, and raising capital, new areas for highly math and physics focused students.

To accelerate the implementation of the program at the university, the core classes in business and engineering and their deliverables did not change, however the context of their work required the students to develop their work into reality while preparing for the tech competition – a precursor to the entrepreneurial event! For the majority of the students, this was the first time they had ever collaborated with students from another discipline, and it forced many of the soft science issues to be addressed in real time, including team building, conflict resolution, and interdisciplinary communications, all necessary life skills, but not traditionally part of the curriculum.

**Resourcing for Proof of Principle**

The university, through the Dean of Business and the Dean of Engineering, created the Center for Innovation and Technology Entrepreneurship (CITE) to coordinate this effort between the colleges. With some initial seed funding and support from the NCIIA and the SBA, a small amount of seed funding was made available to each team for building the proof of principle technologies and assembling their product demo booths.

The use of funds varied broadly from team to team, with some investing in more expensive prototype components, while others invested more heavily in marketing and promotional material for their product. In general there was no correlation between the amount funded and the level of success of the team in the competition. Ultimately their success in the competition was a measure of their ability to succinctly deliver the value proposition, a clear financial plan, and a technology demonstrator that instilled confidence in the judges that the product was technically feasible.

**Supporting Teams for Competition and Launch**

Through the CITE, the university established additional supporting mechanisms for the venture competition and potential company launches including a boot camp, a mentor network, an incubator, and new university IP policies. A boot camp was offered twice a year to provide an intro to the major
elements of tech startups and includes a local keynote speaker who tells their tech start up success and failure stories. An initial partnership with the local Harvard Business Club expanded into a mentor network of over 50 seasoned professionals available to work with the teams throughout the semester.

An incubator was established on campus in conjunction with our Collegiate Entrepreneurship Organization (CEO), that provides office space, meeting space, and lab space to potential UTSA start-ups. Currently this organization boasts over 100 student owned and operated companies at UTSA in addition to the 20 tech venture teams we produce every year. Finally, we established procedures to enable student intellectual property (IP) to be protected just as we protect faculty IP at the university, enabling the university to become an equity partner in start up companies.

**Scientific Study**

The final element of implementing the ACE model via our tech venture competition was to conduct scientific assessments and inform our andragogical theories. We have been tracking student measures associated with the ACE model for five years, and have expanded the study to include comparison universities in Spain and Mexico. This includes a controlled experiment with pre and post-test data studying the treatment effect associated with the tech competition. Additionally, we have used the judges’ feedback and competition scoring to understand where there are weaknesses in the skills sets associated with the students, and in turn, employed curricular modifications to elevate their capabilities.

**CONCLUSIONS**

UTSA has developed a scientifically based model for the acceleration of collegiate entrepreneurship (the ACE model). To deploy this model and overcome the shortcomings associated with traditional business plan competitions, the university launched the $100K student technology venture completion as an interdisciplinary program combining business and engineering undergraduate students to infuse entrepreneurial thinking and experiences into their educational environment. While we do not expect all undergrads to immediately launch a company from this competition, we believe that the structure of the program, based on the ACE model, will help unlock their inner entrepreneur and drive their entrepreneurial intent.
We continue to track the outcomes from this program and are undertaking a longitudinal study to investigate the rate of occurrence of successful entrepreneurial events. In five years, we have had over 550 students pitch over 85 start-up technologies. Nearly a dozen have had university IP and/or incubation associated with their product, and we are seeing the early generation of these companies start-up, hire management teams, and raise significant investment capital. To date the UTSA entrepreneurial ecosystem has been developed with measureable impacts. A positive externality of this business and engineering linkage is the emergence of interest by students in other scientific disciplines. We are in the process of expanding our efforts into the sciences and other areas so that those students can experience “the building of businesses” and include the $100K tech start up competition into their collegiate experience.

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THE TACTICS AND EVOLUTION OF SOCIAL ENTREPRENEURIAL STORYTELLING

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ABSTRACT

Like all entrepreneurs, social entrepreneurs construct communication to persuade stakeholders to provide resources. However, unlike conventional entrepreneurs, social entrepreneurs must develop a complex message that balances both business and social-good themes. Yet it is unclear precisely how such communication influences entrepreneurs’ success in acquiring resources. To address this topic, this study uses a case-based, partially-inductive design to examine the narratives communicated by social entrepreneurs. Findings reveal that entrepreneurs receiving external investment differed from unfunded entrepreneurs in their narrative tactics, characteristics, and evolution. These insights contribute to work on entrepreneurial resource acquisition and organizational narrative theory and have normative implications for practicing social entrepreneurs.

INTRODUCTION

During the past two decades, social entrepreneurship has emerged as a thriving subcategory of entrepreneurial activity (Choi & Majumdar, 2014). Social entrepreneurship involves creating ventures that utilize business methods to address problems harmful to society (e.g. Dees, 1998; Miller, Grimes, McMullen, & Vogus, 2012). It differs from conventional entrepreneurship in several ways including the driving motivations of founders, the centrality of the social mission, the types of business (and social value) opportunities pursued, the diversity of organizational structures and business models, and the expectations of stakeholders (Austin et al., 2006; Corner and Ho, 2010; Lumpkin, Moss, Gras, Kato, & Amezcua, 2013).

Despite their differences, social and conventional entrepreneurship share a commonality: both types of entrepreneurs must construct persuasive communication to convince stakeholders, such as investors, customers, and the
media, to provide them with the resources they need to manage and scale their ventures. However, in constructing stakeholder communication, the two forms of entrepreneurship diverge in an important way. Unlike conventional entrepreneurs, social entrepreneurs are forced to communicate a complex message, which incorporates and balances elements of both business and social-good missions (e.g. Galpin & Bell, 2010). This difference is attributable to the hybrid nature of social ventures and to the fact that, by definition, they are enterprises that must juggle two different, and at times fiercely competing, organizational logics: a social welfare logic, which is focused on the creation of social value, and an economic logic, which is concentrated on financial value (Doherty, Haugh, & Lyon, in press; Garrow & Hasenfeld, 2012; Nichols, 2010). Although the two logics can co-align, they often generate tension – both operationally and in the expectations and priorities of stakeholders (Pache & Santos, 2010).

The existence of multiple logics within the same ventures has implications for how social entrepreneurs craft stakeholder communication. For instance, Roundy (2014) examined how social entrepreneurs crafted narratives, which are discursive tools used to shape one’s own understanding (i.e. sensemaking) or to influence others’ understanding (i.e. sensegiving) of actions, events, or experiences (Brown, 1998; Sonenshein, 2010). Roundy found that social entrepreneurs constructed and communicated three different types of narratives: business, social-good, and personal (2014). Social entrepreneurs’ ability to tailor narratives to fit the preferences of audiences, including investors, the media, and beneficiaries, played a key role in their ability to acquire financial and nonfinancial resources.

While research is beginning to examine how social entrepreneurs communicate with their diverse groups of stakeholders to gain access to the resources they need, much remains to be learned. To address this topic, a multi-case study of social entrepreneurs was conducted. This study finds that funded ventures (i.e. those successful in acquiring financial investment) communicated differently with stakeholders than unfunded ventures. Specifically, the funded entrepreneurs engaged in narrative linking, a communication tactic that involves connecting elements of more than one narrative-type. In addition, these entrepreneurs were also more likely to construct communication with a specific characteristic, narrative multiplexity. Multiplex narratives contain multiple, potential ties to more than one stakeholder group. Finally, the communication of funded entrepreneurs followed a common narrative evolution. These findings
suggest that there are important ways in which social entrepreneurs can differ in their communication strategies, which in turn can impact their ability to acquire resources.

THEORETICAL BACKGROUND

Narratives and Entrepreneurship

A growing body of research explores the role of communication – and specifically, narrative communication – in the entrepreneurial process. This research draws on multiple theoretical perspectives (e.g. legitimacy, identity) and examines how the narratives entrepreneurs use to describe their ventures, products, and actions influence their ability to obtain resources.

A foundational work in this literature is a conceptual paper by Lounsbury and Glynn (2001), which builds on suggestions in prior work about the link between new venture legitimacy and founders’ use of rhetorical strategies such as issue framing and symbolism (Aldrich & Fiol, 1994). They argue that the stories of entrepreneurs serve a function beyond mere entertainment and that narratives play a critical role in the processes that enable new ventures to emerge. Specifically, stories told by (and about) entrepreneurs can help to create favorable interpretations of the wealth-creating possibilities of the venture, thus increasing the likelihood that resources will flow to the new firm. Narratives influence interpretations by creating and legitimating a new venture’s identity. They define the use of narratives in this way as “cultural entrepreneurship.”

Building on this research, Martens, Jennings, and Jennings (2007) examined the role played by stories in the resource acquisition attempts of entrepreneurs in high-tech industries. In a study of initial public offerings (IPOs), they found that a new venture’s identity, as communicated by narratives in its IPO prospectus, had an influence on resource acquisition that was net of the influence of information about the firm’s resource endowments. In addition, stories that elaborated the rationale behind the new venture’s intended actions and that were embedded with contextually familiar elements had a positive, but diminishing, effect on the firm’s resource acquisition ability.

In more recent work, Garud, Schildt, and Lant (in press) examined the role “projective” stories – narratives about the future of a venture – play in the entrepreneurial process. They explained that such narratives can create a paradox: the expectations that are set through projective stories in order to gain
venture legitimacy can also be the source of future disappointments. If ventures deviate from the projections in their narratives, this will disappoint stakeholders and can result in a loss of legitimacy.

Mantere, Aula, Schildt, and Vaara (2013) explore a similar theme by examining how entrepreneurs use narratives as a way to process venture failure. Their findings indicate that entrepreneurial failure is, in part, socially constructed by entrepreneurs, employees, and the media who create alternative narratives to explain the failure. These narratives help stakeholders to process the failure cognitively and emotionally.

**Narratives and Social Entrepreneurship**

Despite the growing interest in entrepreneurial narratives by these studies and others (e.g. Byrne & Shepherd, in press), research is only beginning to scratch the surface of understanding the role of narratives in social entrepreneurship. To date, only a limited number of studies focusing on social entrepreneurship have placed narratives at the center of the analysis. For instance, in a case-based study of ten social ventures, Ruebottom (2013) found that social entrepreneurs used narratives as part of a larger rhetorical strategy aimed at building legitimacy. In particular, findings indicated that entrepreneurs constructed narratives where they cast themselves as protagonists and those that challenged their attempts at social change as antagonists. By juxtaposing the positions of protagonists and antagonists in their narratives they attempted to create tension and build legitimacy.

In a multi-stage, inductive study, Roundy (2014) examined narratives used in social venture resource acquisition. Findings revealed the existence of three distinct types of narratives, which served as the building blocks for social entrepreneurs’ communication. Specifically, social entrepreneurs constructed: (1) *personal* narratives, defined as compilations of the entrepreneurs’ experiences, attributes, significant life events, and founding stories, (2) *social-good* narratives, focusing on elements of the social problem being addressed and emphasizing the beneficiaries of the enterprise (i.e. the stakeholders receiving the social value that is created), the social problem, the proposed solution, and the social impact generated, and (3) *business* narratives, describing the business and revenue models, providing the “business case” for why the venture will be successful (e.g. its competitive advantage and financial strengths) and featuring the venture’s customers as the primary characters. Roundy found that differences in
entrepreneurs’ use of the three narrative-types were associated with differences in their resource acquisition success. In particular, findings indicated that the funded entrepreneurs tailored their narratives and adapted their usage to match the interests of audiences (e.g. emphasizing a business narrative with investors and a social-good or personal narrative with the media).

The study described in the following sections builds on prior research on social venture narratives in order to develop a more complete picture of how social entrepreneurs use narratives in communication with resource providers. In particular, the study utilizes the simple, three-narrative typology (i.e. business, social-good, and personal) described in Roundy (2014) in order to examine the higher order tactics, characteristics, and evolution of social venture narratives.

METHODS

Research Design

As described, social and conventional entrepreneurship differ in several key ways. This suggests it is not prudent to assume that theory constructed through the examination of conventional new ventures is necessarily applicable to social ventures. Work on narrative use by conventional entrepreneurs does not consider, for instance, the balancing of multiple identities in narratives, which is a unique problems faced by social entrepreneurs. For this reason, a partially inductive research design was used.

A multi-case study was conducted. Through interviews, observation, and the collection of archival data, case studies of eight technology-focused social ventures were constructed. Ventures in the technology space were chosen because, as prior work has found (e.g. Madill, Haines, & Riding, 2005), technology ventures are more likely to seek investment than other ventures. Thus, they represent a rich context in which to examine the interplay between narratives and resource acquisition. All eight of the ventures satisfied the formal definition of a social venture (i.e. an organization addressing a social problem through business methods). Also, all of the founders and lead entrepreneurs either self-identified as “social entrepreneurs,” or referred to their ventures as “social ventures.” The one exception, Omega, was in an industry where virtually all other ventures considered themselves social entrepreneurs.
Data Collection

The traditional sources of qualitative data – interviews, observation, and archival data – were collected. First, semi-structured interviews (of approximately one hour in duration) were conducted with the founder and/or lead entrepreneur of each social venture. When applicable, co-founders and board members were also interviewed. In addition, investors were interviewed for the funded social enterprises. Finally, ancillary stakeholders (e.g. customers, competitors, and non-financial resources providers) were also interviewed. In total, 34 interviews were completed producing approximately 700 pages of transcripts. Table 1 describes the interviews per case.

TABLE 1: Description of Cases and Case Evidence

<table>
<thead>
<tr>
<th>COMPANY</th>
<th>FOCUS</th>
<th>YEAR LAUNCHED</th>
<th>OUTCOME</th>
<th>FUNDING SOURCE</th>
<th>DATA COLLECTED</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alpha</td>
<td>Social services efficiency</td>
<td>2009</td>
<td>Post Revenue</td>
<td>Funded</td>
<td>Amount: $2.2M</td>
</tr>
<tr>
<td>Lambda</td>
<td>Social services efficiency</td>
<td>2010</td>
<td>Post Revenue</td>
<td>Funded</td>
<td>Amount: $550K</td>
</tr>
<tr>
<td>Beta</td>
<td>Donations platform</td>
<td>2010</td>
<td>Post Revenue</td>
<td>Funded</td>
<td>Amount: $1.6M</td>
</tr>
<tr>
<td>Eko</td>
<td>Donations platform</td>
<td>2011</td>
<td>Post Revenue</td>
<td>Non-funding</td>
<td></td>
</tr>
<tr>
<td>Equinox</td>
<td>Action-based social media fundraising</td>
<td>2010</td>
<td>Post Revenue</td>
<td>Funded</td>
<td>Amount: $2M</td>
</tr>
<tr>
<td>Omega</td>
<td>Action-based social media fundraising</td>
<td>2010</td>
<td>Post Revenue</td>
<td>Non-funding</td>
<td></td>
</tr>
<tr>
<td>Lambda</td>
<td>Online marketing</td>
<td>2011</td>
<td>Post Revenue</td>
<td>Funded</td>
<td>Amount: undetermined</td>
</tr>
<tr>
<td>Sigma</td>
<td>Online marketing</td>
<td>2011</td>
<td>Post Revenue</td>
<td>Non-funding</td>
<td></td>
</tr>
</tbody>
</table>

Archival data was also collected for each venture. Using Lexis-Nexis and other media databases all available interviews, news reports, press releases, and other types of external communication were collected (in total, 188 documents). In addition, using the Internet Archive, all information contained on each
venture’s website was collected at six month intervals back to the founding of the venture. Collecting data in this manner allowed for studying the evolution of each venture’s communication.

Finally, in situ observations were conducted of entrepreneurs’ communicating with potential resource providers. For instance, when possible, entrepreneurs were observed pitching their ventures to investors. When pitches were not directly observable, video recordings of pitches were requested.

Data Analysis

After collecting the data, a case study was formed for each venture, which synthesized the interview, archival, and observation data. The case studies contained a narrative description of the history of the venture and information about resource acquisition experiences (e.g. timelines of funding rounds). The average length was 54 pages (double-spaced). ATLAS.ti, a qualitative data analysis program, was used to increase the ease of organizing, sorting, and retrieving the data.

Except for the use of the three-narrative typology (described in Roundy, 2014), the cases were analyzed following established procedures for inductive analysis (e.g. Eisenhardt & Graebner, 2007). Within-case analysis was used to identify the salient constructs and theoretical relationships that emerged from the activities of each venture. In contrast, across-case analysis was used to determine if the insights from any given case were supported by the others. In particular, the “replication logic” (Yin, 1984) was used, whereby each case is treated as an experiment to test if the constructs and ideas generated by previous cases are confirmed or disconfirmed. Finally, tables, charts, and figures were used to facilitate between-case analysis.

FINDINGS

Findings reveal that the communication of social ventures receiving funding differed from that of unfunded ventures in several ways. Funded entrepreneurs linked the three narrative- types and crafted narratives with ties to multiple stakeholder groups. Also, the development of the narratives shared a common progression. Each of the tactics, and the evolution in their usage, is described in detail below.
Tactics

The successful social enterprises did not tell business, social-good, or personal narratives in isolation. Instead, they crafted complex communication that, depending on the audience, prioritized a primary narrative while incorporating elements of the other narrative-types. These interdependencies between narratives were created by linking the three narrative-types. Linking is defined as connecting elements of more than one narrative-type. As the evidence below suggests, this tactic can make narrative communication more compelling.

Narrative Linking

Linking is most clearly present in the funded social entrepreneurs’ communication with investors. In such communication, entrepreneurs do not focus exclusively on their business message. Instead, they link multiple narrative-types by including themes from the personal and social-goods narratives. The other narrative-types are, however, a secondary (or tertiary) emphasis. Table 2 summarizes the evidence of linking in the eight cases examined.

TABLE 2: Summary of Case Evidence

<table>
<thead>
<tr>
<th>Company</th>
<th>Funding status</th>
<th>Business / Social-good linking</th>
<th>Business / Personal Linking</th>
<th>Social good / Personal Linking</th>
<th>Linking all 3 narratives</th>
<th>Total narrative linkages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alpha</td>
<td>Funded</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>4</td>
</tr>
<tr>
<td>Beta</td>
<td>Funded</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>4</td>
</tr>
<tr>
<td>Epsilon</td>
<td>Funded</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>4</td>
</tr>
<tr>
<td>Gamma</td>
<td>Funded</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>N</td>
<td>3</td>
</tr>
<tr>
<td>Lambda</td>
<td>Funded</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>4</td>
</tr>
<tr>
<td>Rho</td>
<td>Unfunded</td>
<td>N</td>
<td>N</td>
<td>Y</td>
<td>N</td>
<td>1</td>
</tr>
<tr>
<td>Sigma</td>
<td>Unfunded</td>
<td>N</td>
<td>N</td>
<td>Y</td>
<td>N</td>
<td>1</td>
</tr>
<tr>
<td>Omega</td>
<td>Unfunded</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>0</td>
</tr>
</tbody>
</table>
Entrepreneurs and narrative linking (evidence).

Linking involves combining two or more of a social venture’s three narrative “building blocks.” Evidence indicates that each of the three narrative types can be linked with any of the others or all three can be used in consort. Examples from Gamma and Beta, ventures receiving funding, can be used to illustrate each of the four combinations of linked narratives. First, business and social-good narratives can be linked. For instance, when Gamma’s CEO pitches the venture to investors he explains:

*It’s a win-win for both sides. We win a transaction or success fee from the restaurant every time we bring a consumer in, and then we take a portion of it and we feed hungry people with it so that when you eat, they eat. Consumers save money, restaurants get clients when they need them most, and a growing societal issue is solved. So this is a business that generates an incredible amount of revenue, but still does good for the community, and effectively, we can eliminate hunger.*

This quotation highlights elements of the business narrative, such as the venture’s revenue model, value proposition, and the primary customer groups. It also contains elements of the venture’s social narrative, such as the social problem targeted and the primary beneficiaries.

Second, elements of business and personal narratives can be combined. For instance, the Chief Strategy Officer of Gamma used a linked narrative to explain the inspiration for the business side of the venture.

*The idea came from the college exploits of my partner, the company’s founder/CEO. He was a student at [prestigious university], working his way through school playing jazz piano. Like many young men, he wanted to take women out to eat but could not afford it. He noticed there were times when restaurants had empty tables, and he thought about a service to fill the most expensive table: the empty one.*
In combining elements of the personal and business narratives, this piece of communication can serve several functions. First, regarding the business narrative, it reinforces the business problem being addressed (i.e. restaurants suffer from an “empty table” problem). It also touches on a consumer “pain point” (i.e. that dining out can be expensive) and suggests that the company has a solution for these problems. Regarding the personal narrative, the founder’s university is mentioned by name perhaps to emphasize the quality of his educational background. Describing that he was “working his way through school” signals the founder’s industriousness and work-ethic. Finally, by describing the founder’s own struggles (“…could not afford it”) he is conveying that the entrepreneur has personal experience with the consumer and business problems.

Third, elements of personal and social narratives can be combined. Gamma’s founder does this in his description of the inspiration behind the social-good component of his venture.

You hit that 40-year old mark and your DNA changes because although you want to make as much money as you can, you get to a point where you start saying, “It's time to give back.” And I discovered a problem. I met a guy named, Tom – a very famous character in Hollywood. At one point he managed about 49% of the Billboard 100. And I was talking to [him] and I said, “Hey, I'm doing this [Gamma] and we're going to take a meal for every meal purchased and donate it to a kid in Africa." And he was shocked, he said, "You know we have a big problem in America." So he introduced me to a bunch of people including some very nice celebrities who are dealing with hunger. And I found out last August that we have 42 million Americans on food stamps, which was absolutely unknown to me. So in December I started volunteering at a place called [Food] Pantry.

Like the previous two passages, this piece of communication can serve many purposes. Most explicitly, the CEO communicates several elements of the venture’s social narrative, including the extent of the social problem and misconceptions about it. Moreover, he also includes elements of his personal
narrative, such as how he came to learn about the problem and to understand his own mistaken beliefs. More subtly, this piece of communication also conveys other pieces of information. For instance, it suggests that not only is the CEO well connected, but his social network includes celebrities. Lastly, the food pantry that he mentions is actually one of the venture’s largest nonprofit partners; so the CEO’s volunteering represents a direct link to the company’s primary beneficiary group.

Why Do Social Entrepreneurs Use Linked Narratives?

Although funded social entrepreneurs emphasize a business narrative with investors, they also (consciously) introduce elements of their personal and social-good narratives into such communication. They do so because, as several entrepreneurs suggest, the social narrative may add incremental value, beyond the business case for the venture. Thus, while it is not thought to be a dominant influence on investors’ overall decisions, it is believed to help sway a decision.

Entrepreneurs’ describe the relationship between the business and social-good narratives using several similar metaphors. They describe the social narrative as “icing on the cake,” the “cherry on top,” and the “gravy on top.” For instance, the founder of Gamma explains his approach to incorporating the social-good narrative. He states, “as I’m pitching investors, I start with the business solution first. But then there’s nothing wrong with adding the cherry on top, which is the hunger piece [the social problem].” Gamma’s CSO expresses a similar viewpoint. He states that the social-good message perhaps serves to “put you over the bar, or gets [an investor] to invest a little bit more than they would have, but I think it's probably closer to a tiebreaker than something that has a black and white influence.”

If the social-good narrative does not have a “black and white influence,” then how might it impact investors? The statements of funded entrepreneurs suggest that it serves at least two purposes. First, entrepreneurs claim that communicating their social-good narrative during a pitch can help to differentiate the venture from traditional businesses in the space that are not able to communicate such a narrative. Gamma’s CEO explains that in pitches he tries to convey the “[business] fundamentals” but that the social narrative is “clearly a differentiator” from other firms. The social enterprise’s CSO explains that, in fact, the reason why the label “social venture” is used when pitching the company is because “it's sort of tough to describe what we do in a way that
differentiates us from other startups.” In particular, although their business model is unique, it is easy to categorize the company as belonging to the crowded “daily-deals” space, which includes companies like Groupon. He explains, “we’re not a daily-deal site, but [Gamma] is essentially getting deals from restaurants. So to create differentiation, to create awareness of what we are doing, the hunger piece is crucial.” The CEO is very conscious of the need to differentiate the company from other firms and to make clear that it is a social venture. Leveraging the company’s social-good narrative, in conjunction with their compelling business narrative, allows him to create this differentiation.

Second, entrepreneurs’ statements suggest another function of communicating the social-good narrative to investors: creating opportunities for investors to realize there is overlap between their personal beliefs and values and the enterprise’s social-good mission. In this way, the social-good narrative provides investors with something they can identify with beyond the business-related characteristics of the venture. For instance, the CEO of Beta explains that their social-good message “appeals to investors’ values.”

I think our investors share our values for the most part. We’ve got an interesting group. There’s a group of guys that are originally from East Asia that have strong values towards helping their country. I have a couple of investors that are Christian, and what we do coincides with their belief system.

Moreover, the CEO believes that their social-good message has caused investors’ families to identify with the venture, more so than with other investments.

The greatest interest in the social [good] side has been from investors’ family members. So almost every one of my investors said that their family is more interested in this investment than anything else that they do. Their family is always asking them questions. ‘What’s up with Beta? When can I get the parents from our kids’ classroom to maybe try it? When can we get it into our church? They’ve become kind of behind us – even though we haven’t met a lot of them – they’ve become very much
behind the scenes proponents of us because I guess it’s a story they like to tell. It’s much nicer to tell their peers about the family’s investment in this than it is an assisted living home or a steel company.

These statements suggest that social-good narratives provide investors with another way to connect with, and participate in, a venture and, perhaps, give them a story that they can tell and receive benefits from participating in.

Are Investors Influenced by Social-Good Narratives?

It is clear that entrepreneurs believe that investors can be influenced by linking social-good and business narratives – even if the influence is simply the “cherry on top” of a compelling, business-focused pitch. However, are investors in fact swayed by such practices?

Most investors claim that non-business narratives had limited influence on their decision to invest in the successful social enterprises. One of Gamma’s investors, for instance, described the role played by the social-good narrative in his angel group. He viewed

the social message as a marketing technique. That deal was done based on does Gamma have something that will take off, and all the restaurants in America will see its merit, and there will be wealth built. I don’t think anybody in our group invested in it so that money will be given to a food bank [i.e. the social-good component of the business].

Such statements, of course, are not evidence that investors were unaffected by the non-business narratives. For instance, the social-good and personal narratives might operate at a level at which investors are not conscious (Wentura, Rothermund, Bak, 2000). Or, investors may simply deny being influenced by such narratives because they believe they will lose credibility within the investment community if they admit to considering anything beyond the “business facts” of an investment.

There were some investors, however, that admitted to being influenced by non-business narratives. For instance, one of Alpha’s investors states that,
while he does not think that the social-good message was hugely influential with other members of the angel group, he himself was influenced by the CEO’s social message.

I’ve never admitted this before, and in this [angel] community it’s really an odd thing to say, but I do get fulfillment out of putting my money to work in something that provides more than just a financial return. I’ve seen it work so well over the last 25 years at Nature’s Foods that I’m convinced that corporations are the most enabled to solve any of the world’s problems. A responsibly run organization, using a portion of its profits for social good – I know that for some people that probably sounds like communism – but to me that is the future and I think the world will be a much better place as a result of it.

He goes on to describe the particular mind-set of an investor that is most likely to be influenced by a social-good narrative.

So I think the solution that Alpha provides really enhances people’s lives. And so the investor must be doing it with a broader mindset, that ‘yes, it’s an investment, I need a return on it and there’s a less tangible aspect. I can have an impact through this investment. I can do something good.’

Linking Business and Personal Narratives

Although entrepreneurs emphasize linking their business and social-good narratives, investors make statements suggesting that combining founders’ personal narratives with their business narratives can be influential. As discussed previously, personal narratives can be linked to business narratives to introduce information about prior work and life experiences that are relevant to the business. This can help an entrepreneur engender credibility and inspire confidence with investors. For instance, the lead investor in Beta describes being influenced by the founder’s personal story, which is based on a unique collection of work experiences that culminated in the founding of the venture.
I believed in [founder] and thought that, one, his story was compelling and, two, he really had done a lot of work on this, that it was worth putting some money into it.

Linking personal and business narratives can also reinforce entrepreneurs’ passion for the business. The director of an incubator that evaluated Lambda’s pitch confirmed this.

There’s a personal narrative behind it [the business message], what makes it even stronger it conveys passion and all the other intangibles that people invest in.

Although he explains that the founder’s passion was an important criterion in accepting the venture into the incubator, he also reiterates, “you can't get there on passion alone.” A second evaluator at the incubator, also an angel investor, found four elements attractive in the pitch.

What I saw was a strong personal story – [the founder’s] story and his family member’s health issue – an intense market pain, [the founder’s] personal domain expertise, and market size. For me those four things were key.

Thus the venture was perceived as attractive because the founder’s pitch communicated both personal and business factors. Indeed, the former director of the incubator explains why he advised the company’s founder not to drop the “social good / personal angle” from his pitch.

It’s an intricate part of the story. It’s what gets your attention and gives [the founder] some credibility with certain groups. I mean, he’s going to get their attention with the strong personal story, but then he’s going to really get their attention when he says, ‘we can reduce the cost of your application process by 90%’

The informant’s statement suggests that, in additional to capturing attention, another important function of linking business narratives with social-
good and personal narratives is to provide information that creates credibility with certain stakeholder groups. For instance in this case, the founder’s personal story demonstrates that he has first-hand experience with the social problem the venture is addressing. The statement also reinforces that, at least in this informant’s eyes, what really captures the customer’s attention is the venture’s business solution (i.e. that it will “reduce the cost of [the] application process by 90%”). However, the previous statements are evidence that the pitch’s persuasiveness is not solely attributable to the business narrative. These findings suggest the following proposition.

**Proposition 1.** *Social entrepreneurs communicating linked narratives are more likely to receive funding than other entrepreneurs.*

**Multiplexity**

There is evidence that the narratives of the successful social ventures also possessed an additional characteristic: multiplexity. Multiplex narratives contain *multiple, potential ties to more than one audience.* In the context of social enterprises, such narratives have multiple, potential ties to customer and beneficiary groups. As will be described, multiplexity influences the persuasiveness of narratives by providing more points of connection, so that a greater number of audiences can identify and interact with the narrative. In contrast, the narratives of unsuccessful enterprises contained less potential ties and, thus, were less likely to influence multiple customer and beneficiary groups.

Multiplexity can be understood by examining how it is used in all three types of narratives – personal, social-good, and business. Table 3 provides a summary of the use of multiplexity in the cases. As it demonstrates, all of the successful ventures constructed narratives with this characteristic.

**Multiplexity in Personal Narratives**

Successful social entrepreneurs linked their personal narratives with (dominant) business narratives when communicating with investors. In addition to these practices, they also created multiplex narratives that described the focal character of their personal narratives – themselves – in multiple ways. By doing so, they created opportunities for multiple groups to connect to the narrative (and to the entrepreneur).
TABLE 3: Narrative Multiplexity – Summary of Case Evidence

<table>
<thead>
<tr>
<th>Company</th>
<th>Funding Status</th>
<th>Business Narrative Multiplexity</th>
<th>Socialgoal Narrative Multiplexity</th>
<th>Personal Narrative Multiplexity (Consumers)</th>
<th>Personal Narrative Multiplexity (Beneficiaries)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alpha</td>
<td>Funded</td>
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<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>4</td>
</tr>
<tr>
<td>Beta</td>
<td>Funded</td>
<td>Y</td>
<td>Y</td>
<td>N</td>
<td>Y</td>
<td>5</td>
</tr>
<tr>
<td>Epsilon</td>
<td>Funded</td>
<td>Y</td>
<td>Y</td>
<td>N</td>
<td>Y</td>
<td>5</td>
</tr>
<tr>
<td>Gamma</td>
<td>Funded</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>N</td>
<td>5</td>
</tr>
<tr>
<td>Lambda</td>
<td>Funded</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>4</td>
</tr>
<tr>
<td>Rho</td>
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<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>3</td>
</tr>
<tr>
<td>Sigma</td>
<td>Unfunded</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>3</td>
</tr>
<tr>
<td>Omega</td>
<td>Unfunded</td>
<td>Y*</td>
<td>Y</td>
<td>N</td>
<td>N</td>
<td>2</td>
</tr>
</tbody>
</table>

The communication of Alpha’s founder and CEO provides examples of the multiplex potential ties between the entrepreneur and the enterprise’s stakeholder groups. For instance, one framing links the founder to the venture’s primary beneficiary group: affluent, working moms.

*So I was a school volunteer and a working mom and I kept noticing that my Blackberry was filling up with reply all e-mail request over whose turn it was to help at table time or help at recess. And the more I talked to working moms, we were all overwhelmed with the communication about volunteering.*

This statement places the CEO in the venture’s primary beneficiary group. It also conveys that the CEO has first-hand knowledge of the problems of this group (i.e. “we were all overwhelmed…”).

In other instances, the CEO describes the experiences that led her to found the venture more broadly. For instance, she attributes her motivation for founding Alpha to her:
Leadership positions in PTA and Scouts. Anyone who has volunteered knows about the difficulties in organizing groups of people - the frustrating process of back-and-forth e-mails, phone calls and sign-up sheets. Good people sometimes drop out because it's a hassle.

This communication portrays the personal experiences of the CEO as connecting her to a much larger group than just “working moms” (i.e. to “anyone who has volunteered”). As described below, this corresponds to Alpha’s attempts to generate interest in their product in groups outside of their primary customer group.

Finally, in other communications the CEO describes her connection to the venture’s primary and secondary customer groups: businesses and nonprofits. She highlights a connection to the business community by explaining:

Before starting Alpha, I was a consultant helping organizations improve leadership practices and business processes. Essentially, I’m an expert in helping organizations improve their performance and better meet customer needs.

Second, the CEO suggests a connection to the nonprofit community. In particular, she describes watching the plight of local nonprofits following Hurricane Katrina.

For a long time, I had regularly volunteered at events like serving Thanksgiving dinner for the homeless, park cleanups, etc. When Hurricane Katrina sent thousands of evacuees to my home town, I saw for the first time how difficult and time-consuming it was to organize and coordinate volunteers. Many people were moved to help, but I kept seeing the same pattern – a few people did most of the heavy lifting, and they quickly burned out from trying to coordinate too many small tasks in addition to their other responsibilities.
This statement appeals to small and medium-sized nonprofits since these organizations often do not have the resources to pay for expensive volunteer-management software.

By describing herself in multiple ways, none of which are contradictory, the CEO provides multiple opportunities for audiences to identify with her experiences. Moreover, there is evidence that the CEO’s multiple portrayals are associated with the company receiving attention from a diverse collection of sources. For instance, they have been featured in media outlets focusing on parenting, volunteering, business and online technology, and non-profit consulting. Each of these corresponds to one of the ways that the CEO frames who she is as an entrepreneur.

**Multiplexity in Social-Good Narratives**

In the same way that social enterprises can attempt to create multiplex ties between their personal narratives and stakeholder groups, they can also construct “dense” social-good narratives that contain many potential ties to beneficiary groups. These narratives are contrasted with narratives that frame the venture’s social mission as narrowly applying to one beneficiary group (e.g. refugees) and are not flexible enough to appeal to numerous groups.

Alpha’s communication can be used as an example. In describing the social-good created by its product, the CEO uses a social narrative that focuses on its primary beneficiary, parent volunteers.

> At schools, parents are called on to bridge critical funding gaps – helping in the classroom, supervising in the cafeteria and library, and supporting fundraisers like carnivals and concessions stands. Alpha gives parents and teachers a simple way to coordinate help that’s familiar to them, similar to launching an online party invitation.

In these quotations the CEO communicates that she understands the problems faced by the venture’s primary beneficiaries and that her product is a perfect solution.

In other communication the CEO focuses on the social problems of other groups that can benefit from the product. In doing so, she creates several, secondary beneficiary groups.
We support [...] workplace volunteering, and faith-based volunteering, people volunteering in their churches and congregations. For large non-profits, like the Red Cross, for example, they have local disaster action teams, and those are volunteer teams. They don't have access to the large proprietary volunteer management software. So they use us to coordinate their groups. We save them one to two man days a month in volunteer coordination time.

Finally, in still other communication, the CEO emphasizes the broadest possible group of beneficiaries that can be influenced by the venture: volunteers of any type.

Any person organizing a group of volunteers can do it much simpler with Alpha. We're sort of like an e-vite party invitation on steroids for group volunteering.

Communication with this degree of flexibility allows a wide array of beneficiaries to form connections to the organization. This is important for a social venture because, as discussed, each of these groups stands to receive the social-good created by the venture. Thus, each beneficiary group can represent a unique collection of supporters. As supporters, these groups may be willing to impart resources, such as donations, volunteer hours, and word-of-mouth endorsements of the social venture.

**Multiplexity in Business Narratives**

Lastly, business narratives are targeted at two groups of stakeholders, a social venture’s investors and customers. The latter group, however, constitutes the main “characters” of such narratives. The successful social entrepreneurs constructed narratives that are multiplex in that they contain multiple potential ties to several customer groups.

Returning to Alpha’s communication, there are several examples of the founder describing the same underlying technology (and product) in multiple ways in order to create and appeal to multiple customer groups. Specifically, the business narrative addresses three groups: corporations, nonprofits, and individual volunteers that want premium services. For instance, in targeting nonprofits, the CEO describes the benefits of the product as follows:
A lot of organizations rely on volunteer leaders to manage other volunteers. But these volunteer leaders, while very well-intentioned, don’t necessarily have the people or project management skill set to be successful in their volunteer roles. This can be frustrating and time-consuming for both leaders and volunteers. So if you can make it easier, structurally, for the leaders to manage their volunteers, you can keep your volunteer leaders and volunteers happier.

In contrast, in an attempt to target corporate customers, the CEO describes the venture as a tool for corporations to reach consumers with their cause marketing messages. Moreover, in separate communication she explains that the technology also allows “large national organizations” to “reach the volunteer ranks.”

Similar to the benefits of multiplex social-good narratives, using business narratives that contain multiple, potential ties to customers can help foster connections to a number of customer groups. This is advantageous to a firm for at least two reasons. First, and most obviously, more customer groups can translate into more potential customers. Second, by communicating multiple ways to frame a social enterprise this can increase the likelihood that an investor will understand and be attracted by the business problem the venture is trying to address. The influence of multiplexity on investors is described in the following section.

**Investor Reactions to Narrative Multiplexity**

Investors’ evaluations of funded social enterprises provide evidence that narrative multiplexity gives investors more than one opportunity to find something attractive about the business. That is, discussing multiple customer groups, each associated with a slightly unique business problem (or “pain point”), increases the likelihood that a given investor will consider the social venture as an attractive opportunity. This is important because, as an investor in Epsilon explains, “if you don’t get the problem, then everything else doesn’t really matter.” In other words, the investor suggests that the quality of a venture’s business solution is irrelevant if the investor being pitched does not understand a customer’s pain point. The investor explains, “[with] a lot of deals
you invest because you get the pain point and whether it’s your uncle dying of the same disease or whether you just like that it’s a more creative way to do things, a big hurdle is understanding that there is an unmet need.” He states that unsuccessful entrepreneurs assume that investors will understand and value every customer problem. In contrast, the successful entrepreneurs communicate in such a ways that puts the investor in the “realm of understanding their customer’s problem.” Again, this suggests that providing links to multiple customer groups increases the likelihood that an investor will identify with one of the business solutions.

The statements of Alpha’s investors provide evidence that they were attracted by the venture’s appeals to different customer groups. For instance, some investors found Alpha’s pitch to small- and medium-sized nonprofits most compelling. An angel investor from their most recent round of funding states his connection to nonprofits as customers.

*My company works with thousands of nonprofits across the U.S. and we’re always evaluating tools in the sector. It took about 5 seconds after evaluating Alpha to see that it’s a homerun*

In contrast, other investors focused on Alpha’s “corporate” pitch, which is based on the idea that businesses will pay to use the site to advertise to their desirable user-base, affluent parents. Two other angel investors from the same angel network explain:

*Alpha is an exciting investment opportunity [because] it is targeted towards a key group: parents who have busy schedules, want to support charitable or volunteer activities, and who have disposable income.*

*I thought having an audience of parents who volunteer at schools, which are highly affluent parents that spend a lot of money, is super valuable.*

Still others were attracted to Alpha’s ability to appeal to multiple customer groups. Another investor describes why he and other members of the angel group were attracted to Alpha.
We like their unique approach to both the parent-focused and cause-marketing markets - we think it's a great public service, and we also think it's a great business."

Finally, one investor associated with Alpha explained that “messy solutions” – that is, business solutions that are complex enough that they can be pitched to appeal to multiple customer groups – are sometimes evaluated more favorably than ventures communicating narrower, and albeit less “messy”, solutions that focus on a single, narrow customer group.

Ultimately, using a “messy” multiplex narrative with multiple framings of the entrepreneur, the social mission, and the business, can provide investors with multiple elements that they can find attractive. Moreover, if the practice increases the number and diversity of the enterprise’s customers, thus improving the firm’s perceived financial sustainability, this will also make the venture more attractive to investors.

**Proposition 2.** Social entrepreneurs communicating multiplex narratives are more likely to receive funding than other entrepreneurs.

**Evolution**

In addition to the above tactics, there is evidence that the narratives of successful ventures underwent a common evolution after founding. In particular, successful enterprises progressed through three narrative phases.

Narrative phase 1 corresponded to the earliest stages of the ventures. During this phase, in both funded and unfunded ventures, social-good narratives dominated. That is, entrepreneurs’ social narratives were significantly more developed than their personal and business narratives. Indeed, during phase 1, business narratives were often entirely undeveloped (i.e. the entrepreneur had not begun to develop a business case for his venture). Moreover, while entrepreneurs possessed a personal narrative – everyone does – they often could not clearly communicate how their personal experiences informed their social venture. Thus there were no linkages between the personal and other narratives (i.e. narrative linking was not possible). Also, since the entrepreneurs did not possess compelling personal or business narratives they would communicate their social-good narratives to all audiences. Finally, during phase 1, the enterprise was likely
to have a single primary beneficiary group: the most obvious benefactors of the enterprise and often the group that inspired the entrepreneur to address the social problem\(^1\). Moreover, if the enterprise had a fledgling business narrative it was likely only connected to one customer group (i.e. narrative multiplexity was non-existent).

In phase 2, for successful entrepreneurs the relative importance of the narrative types changed. In particular, the ventures’ not possessing a business narrative developed one (or if they had a fledgling business narrative it became significantly more developed). However, in many cases, the social narrative was still dominant. But since most successful entrepreneurs had all three narratives available at this phase, they began to emphasize different narrative-types with different stakeholder groups. In addition, successful enterprises also began to develop connections between their narrative-types (i.e. to engage in narrative linking). Moreover, since the social narrative was now more complex, successful entrepreneurs had identified multiple beneficiary groups to appeal to. But since their business narrative was nascent, many still focused on one customer group.

In phase 3, successful entrepreneurs had fully developed business, social-good, and personal narratives. Moreover, the business narrative was now equivalent in importance to the social narrative. Communication was tailored so that the social-good narrative was emphasized with media sources. This communication was also linked with elements of the other two narrative-types and particularly the personal narrative. The business narrative was emphasized with investors. But it too was linked with elements of the other two narrative-types. In addition, the social-good narrative was now broad enough that it could support a multiplexity of potential ties to beneficiary groups. Likewise, the business narrative contained potential connections to multiple customer groups. Amidst these groups, the enterprise still maintained ties to primary customer and beneficiary groups.

The evolution of funded social enterprise narratives can be compared with that of the unfunded ventures. In particular, there are several differences in their narrative trajectories; each involves a social venture getting “stuck” at phase 1 or phase 2. First, the social enterprises that did not make it past phase 1 developed a compelling social narrative but under-invested in the development of other narratives and, particularly, their business narrative. They may have experienced some success generating media attention (because of their compelling social narrative); however, they were generally unsuccessful with investors because with only one narrative to draw upon – their social-good
narrative – they could not tailor their communication to investors. Instead, their communication was dominated by their social-good narrative. As described, such narratives can have an incremental influence on investors, but they are not the basis for investors’ decisions.

Getting stuck at phase 2 also had an influence on entrepreneurs’ ability to secure investment. Unlike the social entrepreneurs that did not make it past phase 1, these entrepreneurs had a business narrative, although it may not have been fully developed. They did not, however, create as many reinforcing ties between narratives as successful entrepreneurs, nor did they have narratives that allowed for multiple beneficiary and customer groups. Instead they focused on the same groups that were the initial target of the venture. As described in the previous section, there is evidence that this is not evaluated positively by investors.

The fact that three of the eight social enterprises did not reach the third narrative phase begs the question, what causes entrepreneurs to become stuck at a particular phase? Or conversely, what influences entrepreneurs’ ability to progress through the three phase? While there are several factors that could arguably affect this process, there is some evidence that entrepreneurs’ experiences seeking funding, and particularly their receptiveness to investor feedback, are an important influence.

What Prevents Entrepreneurs From Getting “Stuck”?

Investment seeking experiences described by Alpha’s CEO are suggestive of how the funding process influenced the evolution of her venture’s narratives. For instance, she explains that she first pitched socially-conscious (i.e. “impact”) investors, but with little success.

_We were pitching socially conscious, high net-worth individuals to begin with. And what we found is they said, “Look you’re not a nonprofit; we don’t want to touch you._

The “impact” investor class can be reluctant to fund for-profit social ventures because the investors often operate more like philanthropists than investors and thus would rather apply their money directly to causes (e.g. buying food to feed the homeless). Lack of success with this type of investor forced Alpha to seek funding from more traditional sources, such as angel and VC
investment. The CEO describes how the iterative, learning process involved in pitching to investors influenced the evolution of her narratives.

But still it’s hard, when it’s your baby, to figure out what exactly [investors want to hear]. So, for me, the learning was learning how fundraising works, learning, ‘What are they interested in seeing? What numbers do they need to see? How does it need to be positioned?’ And then continually getting feedback and feedback and feedback, and practicing and fine-tuning and switching slides out and, ‘Which slide is more important? And, I pitched to this group, and how did it work?’

Beta’s founder describes similar experiences. First, he explains that the venture’s social-good mission initially dominated his communication.

That started as a big piece of our story – that our vision is to contribute $1 billion a year to traditional philanthropy. That was front and center of what we do.

But the CEO describes how fundraising came with a difficult realization: if he wanted to secure outside investment he would need to shift from his heavy social-good focus towards a business focus, at least when communicating with investors and other business-minded resource providers.

And then we realized that’s not what investors are interested in [the social mission]. They like that, but they want to see 50X on their investment. Our investors want to make money. Our clients want to make money. I’m not gonna sugar-coat it: I want to change the world with this, but I want to make a good living as well. And I think what I’ve come to realize is that – I’ve always been the kind of person that I’m like, ‘I don’t care. I don’t want to make billions of dollars. It doesn’t really interest me,’ but I have to take that approach. I have to count dollars more than I want to.
Beta’s founder explains that seeking investment was not enjoyable, but it revealed to him the importance of crafting a message to fit an audience.

*I hated doing fundraising because it was always talking about money and how much money we’re going to make. That’s not why I started this, but in the end you have to speak the language of your audience whether it’s a potential client or a potential investor, and the language that businesses want to hear is how they’re going to make money.*

Moreover, he describes how his personal beliefs made it difficult to transition to more business-focused communication.

*It’s a tough thing to do. I can tell you politically I’m borderline socialist, I’m certainly not a capitalist. I’ve always worked in the Third Sector. So the idea or transition of my whole mentality and my approach in the language that I use to be much more profit-oriented took some soul-searching and took some effort. But, like I said, it’s a lot easier to do that if your business model has a clear bottom line that is tied to impact rather than just impact and ‘we’ll figure out how to monetize this as well.’*

Since many social entrepreneurs have backgrounds similar to this founder’s (e.g. extensive work experience in the nonprofit sector), this is suggestive of why so many also struggle with developing a business emphasis and do not progress past narrative phase 1 or 2.

**Narrative Evolution: Investor’s Perspectives**

It is not just the statements of entrepreneurs which suggest that the investment process helped shape the evolution of successful social enterprise narratives. Investors also describe their influence on this process.

An angel investor that took part in Alpha’s seed and Series-A rounds describes how in the early life of the venture the CEO communicated a dominant social-good message.
[Alpha] was originally framed as a social venture. I don’t think she [the founder] understood where its trajectory really could be. I think what she knew is that it was a wicked smart idea. I don’t think she had any idea how it could be monetized but just had faith in the concept.

The investor explains how feedback from the fundraising process has helped to shape the evolution of the venture’s narratives.

[The shift from social-good emphasis to business] that’s something that has been a natural response to other investors, to clients, basically to the market. The market provides feedback to her vision, to her pitch. So she’s responding to all of the questions people are asking, the questions all of us are asking.

Indeed, a second investor, who also took part in both rounds, explains that fundraising feedback has even led the founder to cease using the label “social venture” because the term suggests that the venture is not a “real business”.

I think she stopped saying it was a social venture, honestly. She started off saying it was a social venture, and then she would immediately have to start digging herself out of – like ‘no, no, no, it’s a real business.’

However, as described in the previous sections, it is important to reiterate that none of the investors suggested entirely abandoning the social-good message. Instead, they suggest that entrepreneurs should embed their social mission into a dominant business narrative. For instance, one of Beta’s investors, who invested in both seed and Series-A rounds, explains how the venture initially had a strong social-good emphasis, but that the founder’s emphasis in communication with investors “has really moved over the last 18 months into a more sophisticated approach of entrenching the social component into consumer transactions [the business side of the venture].” But, as this quotation suggests, moving from a pure social-good emphasis to a more nuanced narrative that
combines elements from the social-good narrative with the business narrative, takes time.

**Is Every Phase Necessary?**

An important, unaddressed question is, is it necessary for social enterprises to spend time at each of the three narrative phases in order to be successful in acquiring resources? Or, can a social enterprise “skip” to the third phase (i.e. simultaneously develop compelling and interconnected business, social-good, and personal narratives very early in the life of the venture)? Of the five venture’s successful in securing external investment, four closely followed the evolutionary trajectory described above, spending time at each of the three phases. Moreover, one could argue that narrative phases 1 and 2 did serve a purpose for these social ventures. First it seems to have been important for the ventures to start with a strong social narrative because such narratives generate the early resources and support that can help get a new venture off the ground. For instance, several entrepreneurs explained how they believed their social-good narratives gave them significant advantage in attracting high quality employees. Similarly, the social-good narrative also helped entrepreneurs attract volunteers. Lastly, beginning with a dominant social-good narrative may signal to some stakeholder groups that the venture is in business for the “right reasons.” That is, it is clear to stakeholders that the social mission is the driving force behind the venture and not something that was merely added on after-the-fact (e.g. as a marketing tool).

Finally, although there may be other evolutionary narrative paths that can lead to funding success and failure, seven of the eight firms in this study began in a similar narrative position and set off on the same evolutionary path (although, as described, some social enterprises got “stuck” along the way). Over time, the most successful ventures developed a compelling, complex, and interdependent set of narratives that could be tailored to different audiences and that had potential connections to multiple stakeholder groups.

**Proposition 2.** Social entrepreneurs following the three-phase narrative evolution (described above) are more likely to receive funding than other entrepreneurs.
DISCUSSION

The findings of this study illustrate that, rather than using the narrative-types in isolation, social entrepreneurs can utilize different combinations of the three narratives. The study also provides evidence that an important characteristic of social enterprise narratives is their multiplexity – i.e. multiple, potential ties to more than one audience. Finally, this study demonstrates that social enterprise narratives, and the structural linkages between them, evolve over time. Taken together, this study develops a framework to explain how variations in narrative construction and deployment can influence variations in social enterprise resource acquisition success. In doing so, it suggests that differences in social entrepreneurs’ communication tactics, characteristics, and evolution can explain why some social entrepreneurs are able to acquire resources and others are not.

Implications for Entrepreneurship Theory

First, prior work has acknowledged that multiple narratives can exist within an organization (e.g. Humphreys & Brown, 2002). For example, for a given organizational event, such as an acquisition, there may be an “employee” narrative, a “top-management” narrative, and a “customer” narrative, which are developed by each of these groups and represent their attempts at making sense of (or politicizing, legitimizing, or controlling) the event. Since these groups have different interests, their narratives are often conflicting and inconsistent. Extant research has not, however, explored how a single group in an organization (e.g. the founders) can construct and deploy multiple, consistent narratives. The evidence presented in this study suggests that social entrepreneurs create three primary narrative-types, which they use to emphasize different – but non-conflicting – facets of their venture to different audiences.

Second, in not focusing on firms’ ability to construct multiple consistent narratives, prior research has not examined how such narratives can be linked. Thus it is not understood what effect linked narratives can have on an organization’s audiences. This study reveals that not only can narrative-types be combined but that doing so can increase the persuasiveness of communication with resource providers.

Third, although there is a small body of work which has acknowledged that individuals understand time in terms of narratives (e.g. Cunliffe, Luhman,&
Boje, 2004; Shipp & Jansen, 2011), there is limited work examining how an organization’s narratives change over time. Moreover, the effect that temporal dynamics have on narrative persuasiveness is also previously unexplored. Evidence suggests that not only can a firm’s narratives change over time but that an organization’s position on the evolutionary path of their narratives can influence their ability to acquire resources.

Implications for Practicing Entrepreneurs

This study suggests that entrepreneurs should pay deliberate attention to the narratives they construct and, more specifically, how such narratives can interact. Narratives are not simply a reflection of an individual’s prior cognition. Rather, narrative construction can represent an active attempt at sensemaking. For this reason, it is not merely “talk.” For instance, if entrepreneurs are able to construct narratives that interweave, or produce resonance between, elements of their business and social missions, then this suggests that they possess a deep understanding of how the two features of their venture operate. It is important for entrepreneurs to think of the two components of their venture as related because many social entrepreneurs view the business side of their venture as merely a revenue generator (or “cash cow”), which exists to fund the creation of social-good. Thus, their business model is viewed as a sort of “necessary evil,” which the entrepreneur tolerates in order to fulfill the goals of the social mission. But, like failing to develop a personal narrative, treating the business side of the venture as little more than a means to an end rather than as a critical and interdependent component of the venture that can have a synergistic effect with the social mission, is a missed opportunity.

Finally, this study suggests that social entrepreneurs should strive to conceive of and communicate about their business models and social problem solutions broadly. The successful social entrepreneurs did not “pigeon-hole” themselves with limited narratives that described the venture in very narrow terms. Rather, they tried to cast a wide net and communicate about all of the potential customer groups and beneficiary groups that could be served by their venture.
Directions for Future Research

The theoretical and empirical insights presented in this study were generated inductively and from a relatively small sample of ventures. Thus, the most obvious next step would be to test the propositions presented deductively and using a large sample of entrepreneurs. One way in which this could be accomplished is to assemble a large corpus of social venture investment pitches. Using computer automated text analysis (CATA), these pitches could be analyzed for the extent that they include language related to personal, social-good, and business narratives. The results of this analysis could then be used to predict the likelihood of receiving investment. Even though receiving external investment is an imperfect measure of venture “success,” this type of study could represent a rough cut at testing the proposed relationships.

Because of the important role attributed to narratives by the practitioner literature (e.g. Pekar, 2011) and the social entrepreneurs interviewed, this study focused exclusively on narrative communication. However, there are other, non-narrative forms of communication. In fact, similar to the debate in the practitioner literature about what type of narrative is most effective (“economic” or “social”) there is another debate about what type of information is most persuasive: narrative or non-narrative. As one entrepreneur explains: “Metric-heads insist on quantitative measures that “prove” an initiative’s ROI, while story-huggers opine that numbers can’t ever convey the value of lives transformed. Who’s right?” (Moore, 2011). Thus, one of the most pressing topics of future research is how non-narrative communication is used in social venture resource acquisition and whether narratives, are, in fact, more or less compelling.

Finally, social ventures are an increasingly vital component of society. Therefore, it will be important to understand what elements of traditional models of organization apply to this organizational form and what features of social enterprise will require novel theoretical insights. In essence, we must ascertain how much of the “plot” of social entrepreneurship has been revealed in the narrative of traditional enterprise and how much is a new and untold story.

Keywords: social entrepreneurship; resource acquisition; new venture communication; narratives; case study methodology
REFERENCES


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¹ At this phase, a venture may not have had a business *narrative*, but they still had a business and were thus a social venture (rather than a nonprofit or a charity). However, they had not developed a narrative about the venture’s business model, solution, revenue, and customers.
INCROWD CAPITAL, LLC: 
CASE STUDY AND TEACHING NOTE 

J. Mark Phillips
Belmont University

ABSTRACT

This case provides a unique look at an entrepreneur in the emergent field of equity-based crowd-funding that must choose between fulfilling his original mission of forging a new business model to obtain immediate revenue. Phil Shmerling founded InCrowd as an equity-based crowd funding platform, a platform that would have been illegal prior to federal government’s passage of the JOBS Act. However, the SEC’s implementation of the law was indefinitely delayed, forcing Phil to shift strategy and find other sources of revenue. Phil identifies several choices for moving his business forward, each of which poses its own set of opportunities and challenges. Ultimately Phil must choose a course that not only makes profits but also adheres to his original mission.

INTRODUCTION

In his daily perusal of the online morning news, Phil Shmerling ran across yet another article about the now-distant passage of the JOBS Act. It was early April, 2013, and though it passed almost a year ago, the implementation of the Jumpstart Our Business Startups (JOBS) Act was being delayed yet again by the SEC. The legislation that promised to open the flood gates to crowd-funding for entrepreneurs had yet to fully take effect, and there appeared to be no firm deadline for its ultimate implementation.

This news would be hard enough for the owner of a fledgling start-up, but as the owner of new crowd-funding start-up based entirely upon the passage and implementation of the JOBS Act, Phil found the news devastating.

Sage Advice that Started it All

“There’s no Betty Ford Clinic for entrepreneurial addicts.”

Mike Shmerling, Choice Food Groups
Phil recalled the conversation that started it all over two years ago with his uncle Mike Shmerling, then a senior executive at Choice Food Groups where Phil had worked for three years. With some reservations about how he might be received, Phil approached Mike about the prospect of resigning in order to start his own crowdfunding funding business. Phil remembered telling him that he felt as if he had no choice in the matter, that he simply had to run his own business—he felt as if it was in his blood. As a successful entrepreneur himself, Mike understood where Phil was coming from. Phil recalls fondly that Mike told him “there’s no Betty Ford Clinic for entrepreneurial addicts.”

From a very early age Phil wanted to run his own business. He was inspired by the entrepreneurial stories of friends and family, as well as entrepreneurs made famous in the media. While he felt strongly that he would one day run his own business, yet he also felt strongly that he was the type of person who would want a firm education and broad base of experience before venturing out on his own.

Phil studied finance and accounting at Indiana University’s Kelly School of Business, and upon graduation took a job as an investment banking analyst at Morgan Keegan in Memphis, TN. He worked there for a little over three years advising clients on complex mergers and acquisitions. His experience at Morgan Keegan was rewarding and educational, but he also developed a deep disenchantment with the inherent limitations in the investment and funding of new business ventures.

In particular, Phil grew to dislike the inequities inherent in the investment landscape. He took particular issue with the inability of average investors to access burgeoning new companies. Without the requisite wealth to be certified as an accredited investor under SEC guidelines (which required a new worth of $1,000,000, or yearly annual income above $200,000), individual investors generally could not invest in companies outside of stock exchanges. Entrepreneurs were likewise limited in the methods in which they could advertise or seek funding outside of VC or public offerings, which were also heavily regulated. Phil developed an early passion for the prospect of leveling the playing field, such that 1) investors below that lofty accredited investor status could invest in businesses, and 2) entrepreneurs could get funded more easily, from a wider array of investment sources.

This observation stayed with Phil as he moved on to his next engagement with Choice Food Groups. While he enjoyed the task of assisting clients with complex transactions, he ultimately wanted to learn how to run a business
himself. With this in mind, Phil took a job at Choice with the intention of exposing himself to all critical areas of the business, from supply-chain and personnel management to financial and strategic planning. His goal was to gain experience in every aspect of running a complex business with the express intent of ultimately putting this experience to work in his own company one day.

That day came when congress began a much-publicized debate on the JOBS Act, a piece of legislation written for the purpose of opening up the investment limitations that Phil had come to dislike early in his career. Seldom does major federal legislation open the doors to true business opportunity, but Phil felt that this was certainly one of those times. Armed with a wealth of knowledge and experience, as well as a small amount of personal savings, Phil spoke to his Uncle about starting his own business. In his own words, Phil felt as if he “no longer had any choice about starting his own business.”

From the very beginning Phil’s goal was to create a platform that “got businesses funded.” He aimed to increase access to capital for entrepreneurs looking for funding, and to create more equitable opportunities for individuals to invest in young start-ups. In Phil’s mind, the best way to achieve this goal was to join the emergent wave of equity-based crowd-funding platforms, but to optimize a platform given his unique expertise and background and well as the soon-to-be relaxed regulations promulgated in the JOBS Act.

The JOBS Act

On April 5th, 2012, President Barack Obama signed into law the “Jumpstart Our Business Start-ups” Act, (i.e.”JOBS” Act) which promised to free up the obstacles that existed between investors and start-up businesses.ii Among its many provisions, the JOBS Act aimed to change two aspects of the current business investment regulatory scheme. First, it aimed to allow entrepreneurs to openly solicit investment from potential investors. This change was significant because under current law, entrepreneurs were prohibited from publicly advertising for investment or funding. Second, the law would make it legal to establish online portals for potential investors to invest money for equity stakes in business start-ups.

In essence, prior to this act, emergent companies were prevented by law from publically seeking investors for their start-ups. In addition, regulations prohibited companies from raising capital from an online portal from non-accredited investors.iii The JOBs Act ostensibly eliminated these requirements,
but the act also required the Securities and Exchange Commission (SEC) to finalize and implement the rules that would effectuate the legislation. Though the law passed quickly, the implementation by the SEC would take time.

Initial targets for the passage of the administrative requirements were set for the first quarter of 2013, but that deadline passed, as well as other subsequent deadlines, without even preliminary guidelines of how or when the law would be implemented. Some of this delay may have been expected, given that complicated and extensive nature of the proposed rules. However, a further complication arose in the form of a change of leadership in the SEC. By the middle of 2013, the bulk of the rules required to turn the JOBS Act into reality had not yet been implemented.

The pace of this legislative implementation stood in stark contrast to the rate at which the initial legislation was debated and passed back in the Spring of 2012 (being signed into law only 5 months after its initial debate!). It was in fact due to this quick pace that Phil was inspired to start his company with such urgency.

A Brief Introduction to Crowd Funding

Crowd funding is the practice of raising capital from many small investors to fund small business ventures (Investopedia). It serves as an alternative to traditional methods of business investment, such as venture capital, bank loans, and the initial price offerings. Crowd funding serves as a method of raising money for startups and small businesses in which a large group of people combine small investments that are pooled together to launch and grow businesses. Crowdfunding typically functions via an internet-based funding portal, and has become more popular today due to the rise of online communication, social networks, and secure payment applications. In fact, there are now approximately 600 crowd funding platforms worldwide, and by the end of 2013, crowd funding investment is expected to reach $5.1 billion in funds raised.\textsuperscript{iv} Crowdfunding makes use of the easy accessibility to vast networks of friends, family and colleagues through social media websites like Facebook, Twitter and LinkedIn to spread the word about new businesses and to attract investors. Crowdfunding has the potential to increase entrepreneurship by expanding the pool of investors from whom funds can be raised beyond the traditional circle of owners, relatives and venture capitalists.\textsuperscript{v}
While crowd funding appears to be a new phenomenon, it actually dates back to the 1700’s when Jonathan Swift launched the Irish Loan Fund, a microfinance style of crowd funding. Today, crowd funding is mainly known for its connection with social websites, bringing the “crowd” and “web” together as the two essential elements for defining crowd funding as an activity. In general, there are four main types of crowd funding: microfinance, peer-to-peer loans, donation-based crowd funding, and investment crowd funding.

**Microfinance:** Microfinance is when contributors provide financial services, usually very small loans, to low-income clients, who lack access to banking services. Microfinance platforms such as Kiva and myEllen.com, based out of Prague, have illustrated how successful the market can be. Kiva was the world’s first person-to-person lending platform in which potential investment backers can search through entrepreneurs, read about them, and pick who they would like to invest.

**Peer-to-Peer Loans:** Peer-to-peer loans, or social lending, allow individuals to borrow from a group of lenders instead of using an official financial institution as an intermediary. By doing this, borrowers receive lower rates while lenders earn higher returns than what would be expected from a savings account.

**Donation-Based Crowdfunding:** Donation-based crowd funding startups are typically creative, community, or philanthropic projects. When contributing to a donation-based project, one is guaranteed no financial return, but instead will receive a non-monetary reward related to the project, like a t-shirt, pre-released CD, or unique experiences. One popular site that utilizes this model is Kickstarter.com, a site which was originally conceived as a donation-based site but has drifted slowly toward the edges of investment crowd funding.

**Investment Crowdfunding:** With investment crowd funding, the investor earns a return on investment in exchange for their contributions. This type of crowd funding had been prohibited in the United States by regulations dating as far back as 1934. It is this Investment crowd funding that stands to change most radically upon passage of the JOBS Act, and it is this type of platform that Phil initially conceived his business as executing as part of its competitive advantage.

Phil felt that enormous opportunity existed in the field of crowd funding, yet his initial examination of the playing field proved difficult. While his
research on the industry led him to conclude that there were approximately 600 websites currently available that offer some sort of crowd funding service. The majority of those were peer-to-peer lending or donation based, some of which promised to enter into equity financing in the near future. Other platforms committed exclusively to equity financing pending the enactment of the JOBS legislation. It was difficult to ascertain who the real players would eventually be, and it was difficult to know when he would be able to get a real sense of his competitors given the unpredictable nature of the law’s implementation.

Phil did, however, feel relatively strong about his choice of basing his operation in Nashville, TN. While there was admittedly a personal element to headquartering in Nashville given the proximity of family, he also felt that the City was a solid choice for a venture based the participation of new entrepreneurs. For years Nashville had been noted nationally for its entrepreneurial spirit. A variety of publications, including Entrepreneur Magazine, Kiplinger, and the website under30ceo.com, had ranked Nashville as a top city for entrepreneurs over the four years preceding his launch date. Nashville was widely regarded or its relatively low tax rates, high number of start-ups (over 2,000 start-ups/100,000 people\textsuperscript{ix}), high number of universities with entrepreneurship programs (such as Vanderbilt and Belmont University), and strong footholds in growing industries, such as healthcare, biotechnology, automobile manufacturing and music/entertainment.

While a strong city in its own right, Nashville also had the unique benefit of being within reasonable driving distance of other major Southern cities, such as Atlanta, New Orleans, Louisville, and Birmingham. Phil integrated this attribute into his strategy by developing a regional, Southern focus as opposed to many potential competitors mass-market or large market approach. He felt that this could be a significant advantage given the richness of opportunity he saw in the region as well as the relative lack of attention given specifically to the area by many of his potential competitors. As such, he felt that person-to-person leg work might be required to establish contacts and reputations in the region.

**The Launch of InCrowd Capital, LLC**

Phil initially founded InCrowd Capital in March of 2012, well in advance of the passage of the initial passage of the JOBS Act. However, in truth, Phil had been planning the initial roll-out of the business since late 2011. While he admits that part of his rush to start the company was his exuberance for coming
passage of the legislation, he also felt that the market could quickly become flooded once the law was implemented, and therefore the first-mover advantage enjoyed by the earliest companies to emerge would provide significant benefits.

To launch his company with maximum chance of success, Phil enrolled in the Accelerator Program at the National Entrepreneurship Center. Accelerator programs offer entrepreneurs a chance to develop their entrepreneurial vision during a short period of time with the concentrated assistance of mentors, fellow entrepreneurs, technology support, and potential investors. There, he worked with mentors and experts in order to hone his vision, fine-tune the business model, and test his assumptions with a host of extremely experienced entrepreneurs.

Phil envisioned InCrowd as an online platform that connects accredited and non-accredited investors with entrepreneurs seeking to raise capital to fund any number of their business’ future goals. In essence, InCrowd was created to bring investor and start-up together, and ultimately to get start-ups funded. Start-ups within the InCrowd family would determine their capital goals and the percentage ownership they were willing offer. Investors in the InCrowd Family would search for companies that fit their risk profile, and then pledge their money for an ownership stake in the company. The investor’s funds would be held in an escrow account, and would only be released when the company’s entire funding goal is met. If the funding goal is not met, the investor’s capital is then returned. One key feature of InCrowd’s platform is that it is completely free for investors. This model provides a major incentive (compared to what used to be little to no incentive) for investors seeking riskier investments with potential for higher returns.

In order to establish the functional site, Phil contracted software developers to create a proprietary crowd funding online platform that would ultimately serve as the main component of his business. The platform would enable prospective businesses to raise money from potential investors by signing up and providing a modicum of streamlined, but carefully selected information. First, the companies would be required to provide information that fulfills the SEC requirements (while the JOBS Act did promise to ease SEC disclosure requirements, there would undoubtedly still be some disclosures). InCrowd has conceptually designed the platform application to ensure entrepreneurs are compliant with all applicable laws and regulations by slowly walking them through the process. Potential entrepreneurs will answer questions in a step-by-step process when posting to the platform. This is meant to avoid any material
omissions or misstatements on behalf of the entrepreneur since they are ultimately responsible for the accuracy of the information.

Secondly, Phil drew upon his past business experience to develop a list of salient information that could be used by potential investors to evaluate and match with potential investments. This is one area where Phil felt that he could distinguish his company from competitors—by providing concise, yet vital information on start-ups that would enable potential investors to make confident decisions regarding their investments. In order to establish and maintain the integrity of the platform, Phil or his team will screen each potential entrepreneur before granting them access and use of his platform.

Phil developed a highly localized roll-out plan for InCrowd. He had established roots in the Tennessee and southern states, and felt that this particular region would be less targeted than some competitors who appeared to be working toward nationwide, or at least bi-coastal, brand recognition. Phil targeted Nashville, TN, at the time a growing hotbed of entrepreneurial activity with a focus on the healthcare and music industry. Phil focused on establishing relationships with target incubator programs within colleges and universities, such as Vanderbilt and Belmont University. He intended to make his platform the go-to site for burgeoning entrepreneurs who were working with established programs in entrepreneurship.

Phil utilized his own personal savings to launch the business, and was able to run lean in the early stages by contracting out the software development on a freelance basis. His only employee at the outset was a part-time intern, whom he utilized for certain research early site development and beta-testing. By all appearances, his vision, planning, and execution all came to fruition as planned. The only problem was that after over a year of planning and initial implementation, the SEC still had yet to finalize the rules that would implement the JOBS Act. Until then, Phil’s business was in a holding pattern.

The brick wall that Phil faced not only stressed Phil’s meager financial savings, but also placed burdens upon his personal life. Phil got married shortly before his launch of InCrowd, and though his wife had long known of his entrepreneurial aspirations, neither of them had anticipated the current drought of activity (and revenue) due to government stalling. Further pressure mounted upon the announcement of that they were expecting their first child—a blessing no doubt, but an expensive blessing nonetheless.
InCrowd Capital at a Critical Juncture

Phil was understandably frustrated by the SEC’s intransigence. He had built the beginnings of a viable business, but could not fully test it until the final rules were implemented. He was stuck. And while the virtues of bootstrapping, lean management, and self-funding had served him well to this point, his well of cash would soon run dry—well before he was even able to fully roll out and test his website.

He contemplated his options carefully. It occurred to him that he could seek outside funding to ride out this stretch of inaction. He felt certain that the SEC would ultimately act, but it was just a matter of when. Perhaps some bridge financing in the form of a loan or partner/investor would help him reach that critical time period. However, Phil instinctively disliked the shackles that came with investment partners as well as the burdens of interest and personal collateral. Every ounce of his being felt that outside investment would be a bad fit for this venture.

Instead he endeavored to find one or more alternative product or service that could deliver profits, at least for the time being. He entertained several possibilities. One potential idea, Phil thought, would be to offer, a la carte, some of the software and network products that he planned on developing to support his eventual rollout of the crowdfunding platform. For instance, Phil entertained the notion of creating branded marketing pages for university entrepreneurship and business accelerator programs. His vision was to create a database of programs that people (entrepreneurs, professors, alumni, etc.) would be able to access for information, and therefore build awareness for such programs. He felt that this fit somewhat with the central mission of InCrowd because it would establish a platform in which individuals could locate companies in programs that they felt strongly about and would consider investing in—this would establish some firm networks in anticipation of crowdfunding become fully legal. In a similar vein, Phil toyed with the notion of developing the customer management software (CRM) that would assist entrepreneurs and investors who had already been connected. The goal with such software would be to enable investors to monitor and manage critical aspects of the company they invested in without relying upon a string of emails from busy CEO’s. This would essentially facilitate the relationship between entrepreneurs and their financial stakeholders, an ancillary service that Phil had intended to develop to support his initial carnation of InCrowd.
Ever hungry for profit, Phil entertained the notion of more radical departures from his original business plan. One possibility was creating a platform through which he could pair up a greater number of Angel investors with a higher number of start-ups. He referred to this hypothetical platform as a Micro-Angel Contribution Fund (or MAC fund) which would be a series of angel groups, each limited to a set number of angels, that focus upon investment opportunities from a specific industry. He envisioned this as a means of tapping a deeper pool of investors—albeit, accredited investors—and connecting them with a wider net of potentially successful entrepreneurs. Angels would pay a relatively small investment buy-in, which would be pooled with other angels’ investments into a general fund used to make seed investment in start-up companies (InCrowd would take an initial cut from this pool as its sole payment). Thereafter, Angels within the fund could invest in the amount and duration of their personal preference, but they would do so with the benefit of knowing such companies had been screened before entering InCrowd. They would also enjoy the benefits of connecting with other Angels within their industry that they could collaborate with on investments.

Finally, Phil toyed with the prospect of simply staying the course and sticking with his original plan. This would likely require him to take on some outside funding, and perhaps partners, to stay the course. This option appealed to Phil because he had worked long and hard on his business plan and wanted to bring it to fruition in its current iteration. However, Phil disliked the burdens of debt, and wanted to steer clear of outside equity partners.

Each of these ideas held promise in the short term. An initial investigation into his first idea, branded marketing pages for academic institutions, enjoyed enthusiastic responses from potentials schools . . . that is, until Phil raised the prospect of paying for such services. Phil was encouraged about the potential demand, but either had to find some other way to monetize it, or find a large-scale growth model that would create critical mass and therefore the expectation that schools needed to be on the site. Phil also began to balk at the sheer amount of time that would be required to build and update the amount of pages he envisioned as necessary to make this a valuable resource. This was a daunting task, but he felt that if done properly, it could also serve as a foundation for the ultimate roll-out of InCrowd’s crowd-funding capability.

Likewise, the communications and CRM platform he envisioned also garnered initial interest from potential customers, but they similarly balked at paying fees for such a service. Phil felt confident that these services would
provide a valuable service to existing investors and entrepreneurs, and he also felt that such platforms could likewise be folded into the eventual roll-out of InCrowd’s crowd funding. Perhaps an increased effort at monetizing this service, or enhanced customer education could remedy this obstacle.

The MAC fund possessed the most potential to provide revenue in the short term, as Phil had established a small, but reliable cadre of Angel investors through his prior jobs and networking efforts. Initial feelers into his circle of investors and local business accelerators yielded significant interest, and it appeared feasible to enact some version of this vision within a relatively short period of time.

In many ways this product also fulfilled some aspects of Phil’s original mission, which is to get more start-ups funded. However, it did not fully embrace his notion of equalizing the investment playing field by enabling everyday investors the opportunity to invest in start-ups. This, he felt, could only be done with the crowdsourcing platform. The MAC fund had potential, but Phil acknowledged that very little of this business model could be recycled or refitted to the crowd-funding model he originally envisioned.

Phil faced a dilemma. He had identified some viable alternative paths for profitability, but he wondered whether pursuing them would steer him from his original mission. He had not left his prior job just to form a start-up, he endeavored to build a very specific kind of start-up that fulfilled an important goal that Phil had identified in his prior career. Phil had not abandoned the notion of waiting out the ultimate enactment of the JOBS Act, and perhaps taking on external financing if absolutely necessary. Yet the very law that provided the impetus to start this business now served as an unpredictable obstacle to his success.

With many distinct possibilities in front of him, Phil was uncertain as to what to do. Should he 1) stay the course and take on additional, outside financing in order to achieve the original intent of his business? 2) Offer a la carte software support services and find ways to monetize and market them? or 3) should he devote his resources to the MAC funds and temporarily (and perhaps permanently) abandon his goal of establishing an equity-based crowd funding platform?
This teaching note provides direction for instructors wishing to teach the InCrowd Capital, LLC case. This case provides a unique look at a start-up in the burgeoning equity crowd-funding industry and examines the rare situation in which an opportunity is both born, and thwarted, by a sweeping piece of federal legislation known as the JOBS Act. Phil Shmerling founded InCrowd as an equity-based crowd funding platform, a platform that would have been illegal prior to the JOBS Act. However, the SEC’s implementation of the law was indefinitely delayed, forcing Phil to shift strategy and find other sources of revenue. He can either 1) stay the course and seek outside funding/investors to carry him until the law is implemented, 2) provide a la carte support software products to help connect existing investors and entrepreneurs, or 3) develop an alternative platform that enables a large number of angel investors (currently allowed under the SEC) with a wide net of entrepreneurs. Each choice poses its own set of opportunities and challenges, and Phil must choose a course that not only makes profits but also fulfills his original mission.

Teaching Objectives

This case promotes several key teaching objectives. First, it provides a unique perspective of an entrepreneur founding a start-up in the emergent industry of equity-based crowd funding. Second, it explores a scenario in which a sweeping piece of federal legislation provides the seeds of entrepreneurial opportunity, as well as the reigns that hold back and ultimately threaten the viability of nascent start-ups. Third, it provides a nuanced look at opportunity assessment in an emergent industry—one in which the potential competitors and market landscape are not yet formed. Fourth, it promotes a deep understanding of an entrepreneur’s mission, and the ways in which changing a business model can potentially threaten or enhance the original mission. Fifth, it provides an opportunity for students to assess and map out an entrepreneur’s original business model (including the key constituent parts of value proposition and target market, among others) and map out the changes in that original business model as the entrepreneur entertains several opportunities to pivot his business strategy.
Case Synopsis

Phil Shmerling founded InCrowd with the intent of developing a crowd funding platform to enable average investors to invest in business start-ups. He had long aspired to end the inequitable situation in which most investors were prevented from investing in entrepreneurial ventures due to their lack of qualifying as high income, accredited investors under SEC regulations. In short, Phil’s mission was to a) provide opportunities for the average investor to invest in start-ups, and b) to enable entrepreneurs to seek out a broader spectrum of potential investors and get their start-ups funded.

The opportunity for fulfilling this goal came in the form of the JOBS Act of April 2012, which ostensibly legalized crowd funding for equity investment into start-ups. By all accounts, this law promised to usher in a new wave of business development by providing much needed alternative methods of investment and financing in a broad variety of entrepreneurial ventures. Phil acted quickly to build a business around his personal mission and endeavored to build all the necessary aspects of his business prior to the enactment of the law, which was to take place after certain specific rules and regulations had been promulgated by the SEC in early 2013.

As of late 2013, those rules had yet to be implemented, and Phil’s business model waited to be truly tested in the market. He faced a unique dilemma, in that the very law that created the opportunity that he sought to exploit now prevented him rolling out his business. Phil finds himself in a peculiar place—well prepared for a pending opportunity, but forced to entertain other opportunities for revenue while waiting for the SEC to act.

As a result, Phil identifies several plausible avenues for his company, but, while each is potentially profitable, they also represent a departure from his original mission and plan. In the face of this uncertainty, and in dire need of revenue to keep afloat, he explored other options to survive. Phil identified a number of plausible alternatives. As he saw it, Phil could 1) stay the course and take on additional, outside financing/ownership in order to achieve the original intent of his business? 2) Offer ancillary investor support software products and enhance efforts at marketing and monetizing them? or 3) devote his resources to the MAC funds to connect a broad array of Angel investors with a wide variety of entrepreneurs?
Intended Use

This case provides perspectives that would serve both graduate and undergraduate courses that focus upon entrepreneurship, entrepreneurial finance (with an emphasis on micro-financing or crowd funding), or new venture management. In addition, students majoring in accounting, law, or other regulation related fields with an interest in entrepreneurship may find this case interesting given its primary focus upon legislative change and SEC regulatory change. The case highlights several key issues that illustrate components of the entrepreneurial process, including:

- Opportunity assessment in emergent, and unestablished industries
- Entrepreneurial goal-setting and mission fulfillment
- Adapting, or “pivoting” business models in response to regulatory intransigence

SUGGESTED DISCUSSION AND ASSIGNMENT QUESTIONS

This section provides targeted questions that instructors may use to guide classroom analysis and discussion regarding the case. Each of these questions is designed to support the ultimate decision point of the case—what, if any, changes should Phil make to his business model given his current need for revenue and the hold-up of the implementation of the JOBS Act. The following discussion questions may be taught together in a comprehensive manner or individually, as proscribed the instructor:

1. Given the circumstances, had Phil adequately assessed the opportunity upon which his start-up is based? How does this inform the assessment of the current opportunities that he faces?
2. Do the current options facing Phil reflect the original mission he had in mind when he initially set out to start his company? How does this analysis impact his current decision?
3. In what way to these potential shifts, or “pivots”, impact Phil’s core business model—specifically with respect to the central value proposition and target customer?
Teaching Outline and Analysis

The following section will provide a detailed analysis of each of the above questions. This analysis may be used to assist with in-class discussion by instructors, or as an aid to develop assignments such as written deliverables.

1. **Given the circumstances, had Phil adequately assessed the opportunity upon which his start-up is based? How does this inform the assessment of the current opportunities that he faces?**

Phil entered relatively uncharted terrain when he started InCrowd Capital. While some donation-based crowdsourcing platforms were well established at the time of InCrowd’s inception, no platforms had yet formed an equity-based crowd funding platform. In a relatively empty market place, the JOBS Act legalized equity crowd funding, in a sense creating a clear opportunity for aspiring entrepreneurs.

However, this information alone presents only a partial picture of the full opportunity assessment that entrepreneurs should perform prior to building their businesses. John Mullins, in his work *The New Business Road Test*, sets out a seven-part model that entrepreneurs can use to fully assess their opportunities (Mullins, 2012). According to Mullins, the model highlights several crucial aspects of the opportunity assessment process, the first of which is the need to understand the difference between markets (the potential customers) and the industry (the potential competitors). The second observation makes the key distinction between micro and macro perspectives, while a third highlights the central place of the entrepreneur (or entrepreneurial team) and his connection and capacity to execute the opportunity. These three critical observations culminate in the seven domain model illustrated in Appendix 1, and may be used to help dissect the opportunity assessment undertaken by Phil Shmerling at InCrowd Capital.

With respect to the market, or the potential customers, Phil has chosen a geographic location in the US that promises to provide a strong base of potential customers. Nashville, TN possesses a strong nation-wide reputation as an attractive place for entrepreneurs to launch start-ups. On a macro-level, the area boasts over 4,400 active start-ups in the region as of the time of the launch of InCrowd, a fact that reflects a robust level of activity in the entrepreneurial sphere. Broad structural support exists for entrepreneurs in this region, such as
low tax rates and significant level of educational institutions (approximately ten 4-year institutions) as well as college educated workforce.

With respect to the Micro market analysis, Mullins notes that entrepreneurs must assess what customers view as the competitive advantage of their product offering over competitors (Mullins, 2006). While this question is difficult to answer given the nascent nature of the company (having not even gone to market yet due to legislative blockage), Phil appears to have anticipated a strong answer to this question by making his platform focused on connecting start-ups and investors in a very specific, and potentially overlooked, geographic region. For prospective entrepreneurs who are about to be bombarded with choices as to how to crowdfund their enterprise, InCrowd promises to be one of the select few that understands and focuses upon the Southern US as its region. Another unique advantage is Phil’s personal experience having successfully navigated a reputable Accelerator Program. This background may appeal to budding entrepreneurs who are looking for someone who can not only get their venture funded, but who also possesses a deep understanding of their plight.

With respect to Industry, the analysis must necessarily rely upon incomplete information. While Phil has researched the competitive landscape of donation-based platforms and sites that promise to eventually offer equity-based crowdsourcing, he is uncertain about what the landscape will be like when he ultimately goes to market with his offering. Depending upon how the SEC implements the JOBS Act, his competitors may take on different business models or focus on providing different product/service offerings. Phil himself remains unclear as to the exact format that his crowd funding platform will take due to the uncertainty remaining with the SEC process. As such, we see Phil as an entrepreneur who appears to have performed adequate research on the industry for now, but is currently hamstrung by the delayed implementation of the law. In essence, he cannot fully understand the macro or micro competitive landscape until his competitors are able to enter the market.

In Phil’s case, the central team domain indicated on the opportunity assessment framework possesses strong indicators of his venture’s future success. Phil started his business with a deep sense of mission that emerged from both his prior education and his prior work experience. A central theme that emerged through his finance education and work at Morgan Keegan was the lack of availability of opportunity for the general public to invest in start-ups. He felt frustrated that average, well-informed investors could not invest in start-ups—only high-income, high-wealth investors enjoyed such opportunities.
Likewise, entrepreneurs were hamstrung in their efforts to advertise or seek funding from a wide net of potential investors. Long before the JOBS Act was created, Phil longed to right this inequity. As such, the opportunity created by the passage of the JOBS Act galvanized Phil’s mission and called him to action in building his first start-up.

Likewise, Phil appears to possess the ability to execute the key success factors necessary to make his particular venture successful. He possesses the critical educational and experiential background in venture finance, which makes him ideally suited to handle the nuances of broaching financial deals between prospective investors and investees. He successfully worked through an business accelerator program in which he tested his idea with experienced entrepreneurs, built relationships with strong mentors, and emerged with a host of experiences and skill-sets uniquely suited for a start-up. In addition, he managed a broad array of aspects of an established company at Choice Foods, providing him with the skillset necessary to oversee many disparate areas of business growth.

Overall, the opportunity that Phil is pursuing through the creation of InCrowd Capital appears strong. The weak areas of his assessment appear to be those that are limited by the very nature of the legislative wrangling that currently impedes the implementation of the JOBS Act. With this in mind, the same framework of analysis may be applied (albeit with limited capacity) to the choices that Phil now entertains.

2. Do the current options facing Phil reflect the original mission he had in mind when he initially set out to start his company? How does this analysis impact his current decision?

As touched upon briefly in the above analysis, Phil possessed a unique sense of mission in pursuing the creation of InCrowd. Phil endeavored to create an enterprise the leveled the investment playing field so that 1) more individuals could invest in start-ups, and 2) start-ups could solicit funds from a wider net of potential investors. He now faces the prospect of shifting his business model in order to provide immediate revenue while he awaits final action from the SEC. These potential choices bear directly upon his original mission because, to varying degrees, they require him to adhere to, tweak, or significantly alter his business plan from his original model.

Phil faces the task of ascertaining whether his original goal is adequately reflected in the choices that lay before him. In aligning his goals with his
potential business strategies, Phil may benefit from utilizing the framework set forth by Amar Bhide in his work, *The Questions Every Entrepreneur Must Ask* (Bhide, 1996). This framework provides a simple yet powerful feedback loop of three questions to help guide entrepreneurs in big decisions (see Figure 2).

The model suggests that the first question to ask is whether or not an entrepreneur has well defined goals, particularly with respect to his personal aspirations, business sustainability, and risk tolerance. Once these aspects are clearly defined, Bhide suggests that the entrepreneur must then ask themselves whether or not they have the right strategy, and finally whether or not they have the capability and resources to execute that strategy (1996). The second and third questions should only be answered after the first one has been definitely answered, and if the second or third question is unclear or unanswerable, the entrepreneur is encouraged to return to the prior question in order to more clearly answer it before proceeding.

Phil possesses a clear, well-articulated goal at the outset of his start-up, and it appears to align with this personal aspirations, expertise and risk-tolerance. As such, the first question in Bhide’s sequence appears adequately answered by Phil. However he now faces the choice of several different strategies. The initial iteration of InCrowd squarely reflected his mission, in that equity-based crowd funded served to level the playing field and provide entrepreneurs with a broader opportunity to obtain funding. Therefore his initial option, that of staying the course appears well designed. Bhide’s second question, however, targets the profitability and sustainability of the strategy. The primary problem Phil currently faces is the inability to make any current profit off of his model because of the stalled regulatory implementation of the SEC. Therefore, under Bhide’s rubric, staying the course appears unwise, even in the short run.

Phil’s second option entails providing ala carte communications and network platforms for funders and entrepreneurs that enable them to communicate once they are already connected but steers clear of the platform that actually connects the two parties. This option, though possessing some potential for profit, provides some fulfillment of Phil’s initial goal, but appears to fall well-short of his original mission. He openly concedes that if these options were the only ones available to him prior to starting the business, he likely would not have started it. They simply were not that compelling, or differentiable, to build a satisfactory business upon.

The final option entails developing a platform that connects a higher number of investors—investors who are already “qualified investors” in the eyes
of the SEC—and connects them with young start-ups. This option both adheres to and drifts away from his original mission. It fulfills his original mission by providing a wider net of investors for budding young entrepreneurs, while also introducing new investors to the world of start-up investing. However, the investors targeted in this incarnation are not “average” investors by any definition. They are investors who satisfy all of the current SEC requirements but who, for one reason or another, have not entertained the notion of funding entrepreneurial ventures before.

This presents a complex opportunity to Phil and opens a potentially rich area for student discussion. A key question for Phil’s future strategic choice regards that choices connectedness with his mission, and this strategic option requires deep analysis to determine its long-term viability.

3. **In what way to these potential shifts, or “pivots”, impact Phil’s core business model—specifically with respect to the central value proposition and target customer?**

Phil faces a choice of several strategic options, each of which represent changes to his business model. Understanding the full impact of such potential changes requires an assessment of the full business model, and a look at how each option shifts the constituent parts of that model.

One useful tool for evaluating the core elements of a business model as the model shifts through various iterations is the business model canvass created by Osterwalder and Pigneur (2009). This canvas provides a concise representation of essential aspects of a business model, including: value propositions, customer segments, customer channels, customer relationships, key resources, key activities, key partnerships, revenue streams and cost structures. Blank and Dorf, in their book, *Business Model Generation: Handbook for Visionaries, Game Changers, and Challengers* (2010), utilize the business model canvass and stress that it helps illustrate the salient changes that a business undergoes as it pivots over time. These tools may help observers examine Phil’s current options and compare them to his original incarnation of the model.

Phil’s original conception of his business model possessed a unique value proposition (Figure 3 (a)) that reflected the qualities of newness to the market and customization to the industries and preferences of a specific, and under-targeted geographic region. He targeted a unique cross section of customers that can be bifurcated between potential investors and potential entrepreneurs. The
direct and in-direct aspects of his customer relationships and channels of distribution appear well suited to delivering his primary value to prospective customers. These aspects, as well as others highlighted in the model (Figure 3(a)), provide a clear picture of Phil’s original model, which appears well connected in many respects.

The different shifts that Phil contemplates at the current moment can be reflected in the alternatives presented by Figures 3(b) and 3(c).1 The central feature that shifts between these pivots in the business model appear to be the value proposition. In the second iteration, Phil loses the key value of connectivity between investors and entrepreneurs, because he merely provides tools and online platforms that enable further contact between those entrepreneurs that are already funded. It raises the question of not only whether this option fulfills Phil’s mission, but also whether this paired-down value proposition provides a sustainable competitive advantage, and whether it utilizes Phil’s core competencies and skillset.

Phil’s other choice that of creating a platform to connect a higher number of accredited Angel investors to a higher number of start-ups also changes the central value proposition. While it offers, perhaps a more sustainable advantage than the second option, it does fall short of the full value that Phil initially intended to deliver. This option also affects the target customer because instead of developing connections with unaccredited investors as originally hoped for, Phil would find himself courting investors of a much higher wealth and income level. Students may be tasked with discussing how this change in target market might affect the marketing and strategic plans for InCrowd’s initial roll-out.

As demonstrated in the various iterations of the business model canvas, Phil faces a difficult choice in how to proceed. He aims to fulfill his original mission, but also to stay profitable. Whether those two objectives are obtainable, or mutually exclusive, remains to be seen. However the frameworks of analysis highlighted in this discussion may provide ample tools for an entrepreneur to navigate this difficult choice.

Author’s Relationship with Entrepreneur

Mark Phillips is an acquaintance of Phil Shmerling, who has remained in close contact with Phil throughout the development of his business model, as well as the variety of iterations it has attempted during InCrowd’s infancy. Phil has graciously dedicated his time not only to the development of this case, but
also the community of students at Belmont University, where he is a frequent speaker and contributor.

Figure 1: The seven domains of attractive opportunities (Mullins, 2012)

![Figure 1]

Figure 2: The Questions Every Entrepreneur must Ask (Bhide, 1996)

![Figure 2]
Figure 3 (a): Business Model Canvas for Phil’s original incarnation of InCrowd Capital, LLC

http://www.businessmodelgeneration.com
Figure 3 (b): Business Model Canvas alternative strategy in which InCrowd offers a la carte support services for existing entrepreneurs and investors.

Figure 3 (c): Business Model Canvas alternative strategy in which InCrowd offers MAC accounts for Angel investors.
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Phil’s first choice, that of staying the course, essentially keeps the primary model intact, and therefore the two subsequent business model canvases may be used to illustrate the other two choices laid out the case.
Angela Ruben stretched her back and arms and then she rubbed the bottom of her feet. “I am “bone tired” she thought as she stood up to pack her company’s display booth. She and her husband Chris had just completed marketing the Sticky Paws product line for Fe-Lines, Inc. (Fe-Lines) at the American Pet Products Manufacturers Association (APPMA) trade show in Orlando, Florida. They both loved working trade shows but it was physically and mentally brutal. In addition to setting up and tearing down the exhibit booth, they both constantly stood for ten hours each day to encourage buyers at the trade show to learn about the Sticky Paws product line. Generally there was hardly any time to eat or take a bathroom break. Performance at the trade show set the pace for sales for the upcoming year.

Overall, the two days have been successful. Although they had only been working with the owner of Fe-Lines, Bonnie Pemberton, for a year now, the Rubens were excited about the progress they have made in growing the company! Chris startled Angela as he walked up and exclaimed: “hey, Sticky Paws won the “Cat Fancy” Editor’s Choice Award…I am so stoked! We have to call Bonnie and tell her the good news!”

COMPANY BACKGROUND

Bonnie Pemberton worked in Los Angeles, California, in broadcasting as a voice over performer. She loved her job and enjoyed the challenge of effectively communicating in the different roles she played. When she was not working, she volunteered for several community organizations including a no kill animal shelter. She was an avid cat lover and wanted to help get as many cats as possible adopted. Being around the cats was always difficult because she wanted to bring them home. But she knew that she couldn’t have a house full of cats so she enjoyed the time she spent with all of them at the shelter. One day when she arrived at the shelter she found a box of kittens that someone had dropped off outside of the building. She immediately fell in love with the
smallest of the litter. He acted very courageous and tried to protect his three larger siblings from her. This bravery earned him a new home – she couldn’t resist him. Soon after adopting Buddy, she learned that she needed to return to Fort Worth, Texas, to help care for her mother. After being in Fort Worth for a few months, Bonnie realized that the broadcasting opportunities she had in Los Angeles were not going to be available for her. She had to reinvent herself.

As Buddy grew, he started to use her furniture to sharpen his claws. Bonnie had a lot going on with the care of her mom and trying to discover her new career path. It was a tough time and the last thing she needed was to have to buy new furniture! He also started shredding draperies, wood, and her house plants – he was an equal opportunity destroyer. She researched ways to stop Buddy from this path of destruction and found that there really wasn’t anything on the market that was effective. It seemed as though declawing was the only option to eliminate the daily sharpening. Bonnie researched the declawing process and was horrified to learn of the potential problems cats experience as a result of declawing. In addition to the pain, infection often invades cats’ paws after they have been declawed. Curing this infection often took a lot of time and money. She was not shocked to learn that cats were abandoned or surrendered to shelters for two main reasons: scratching/destroying furniture and the behavioral change in cats associated with de-clawing, including inappropriate elimination.

Clearly, Bonnie faced a dilemma. She could not allow Buddy to destroy thousands of dollars’ worth of home furnishing and plants. However, after her research, she simply could not have Buddy declawed. She continued her trip to pet stores in search of a product that could help train Buddy not to scratch and shred. During this time Bonnie also started to experiment with potential solutions she invented. Finally she found that a double sided adhesive application she developed worked. Buddy really hated anything that was sticky on his paws. **Sticky Paws** was born! Bonnie founded Fe-Lines and became President of Fe-Lines, Inc.

**BONNIE’S STEEP LEARNING CURVE**

Fe-Lines first product, **Sticky Paws**, was a non-toxic, water-soluble, transparent, acrylic strip that is applied directly to furniture, home furnishings, and anywhere else cats should not be. Bonnie had developed the first-of-its-kind product and hoped that she could sell it as a humane solution to cat scratching and shredding. The pictures and descriptions of declawing were always in the
back of her mind and motivated her to keep going forward with her business even when she felt as though she couldn’t.

Bonnie had never planned on starting and operating a business. Her passion had been the broadcasting business, and her voice was her talent. Once she developed the product and tested it to make sure that it didn’t harm any surfaces to which she attached it, she wasn’t really sure what needed to be done to take this product to market. She researched the steps in starting a business and eventually found a producer for the product and developed the packaging and logo.

There were several missteps along the way, but in fall 1997 she eventually found a major trade show that she decided to attend in hopes of getting exposure for her product. She was convinced she had a solution to a problem that many households faced and looked forward to developing this solution into her new career. It was while she was attending this first trade show that she met Chris and Angela Ruben, veterans of the pet products industry. This meeting turned out to be the spark she needed to help her business move forward.

THE RUBENS

Chris and Angela Ruben owned CMR, Inc., a business consulting company that primarily focused on assisting businesses with the marketing area. They worked with business owners in a variety of ways from concept development, market analysis and testing, production, logo and packaging design, promotion, and sales. Both were employed in the pet industry before they were married.

Chris was born in Germany and was employed in the pet industry before he moved to the United States. He met Angela at a U.S. pet industry trade show where she was exhibiting her employer’s new pet beds, leashes, and other pet equipment. There was an instant connection between the two and they found that they had a lot in common. Angela was intrigued to learn that Chris was the person who introduced pig ears as dog treats in the United States.

They remained in contact after their initial meeting and were married within two years. Angela lived in Tyler, Texas, and wished to remain there so that she could help take care of her parents. Chris relocated to Tyler and they decided to open CMR, Inc. They were attending the same trade show Bonnie was attending for the first time. The booth where the Ruben’s were exhibiting their client’s products was located three down from Bonnie’s Fe-Lines exhibit.
During the first day of the trade show, Angela walked the show to see the products, services, and to size up the competition. It was during this walk that she first met Bonnie. Angela noticed that Bonnie was very nervous and uncertain about the answers to questions that she was being asked by potential customers. As they visited, Angela told Bonnie that she and Chris would be happy to help her with anything and showed her where their booth was located. Bonnie came down several times that day to ask them questions about the trade show policies as well as other general business questions. One the second day during a slow period, Chris walked down to check on Bonnie and to provide encouragement. Bonnie started asking him about pricing policies and mark-up. She was concerned that the price point she had set was not going to work. She had printed the price of $9.99 on the packaging for her product, so the final price was set and advertised as part of the packaging.

Chris and Angela met Bonnie for dinner after the show and explained pricing and channels of distribution to her. Bonnie’s fear turned out to be a big problem for her – she had set her initial price too low. At $9.99 final selling price, there was not enough margin to allow her and the other intermediaries to earn the required return. She was overwhelmed and discouraged, but Chris and Angela shared several suggestions of things she could do to minimize the damage. All three enjoyed the evening and a new friendship was formed. Chris and Angela, as young entrepreneurs, wanted to see Bonnie succeed as she started the reinvention of herself. They exchanged contact information and pledged to keep in touch. Fort Worth was a little more than a two hour drive from Tyler and they set a date to meet in Fort Worth for dinner the following month.

THEY LOVE US!

Bonnie was amazed at the immediate response Sticky Paws received after the trade show. She found herself trying to analyze why the product had created such a buzz and then thought to herself “of course they responded, they need help immediately before any more damage is done”. This recognition gave her great pride and satisfaction as she continued to build her business. Her passion for cats and humane treatment, as well as the calls and letters she received daily from cat owners sharing Sticky Paws success stories, carried her forward when she otherwise would have quit.
Within the first year of operation, Fe-Lines, Inc. was introducing *Sticky Paws* nation-wide through Petco Stores, as well as independent pet supply outlets. Also, the product was being sold by telephone and a website, stickypaws.com, was being developed for Internet sales. Bonnie’s confidence was growing along with the company. Total sales at the end of the year, $1,100,000, were phenomenal. Bonnie had never expected that her product would reach that level of sales. However, as growth continued Bonnie realized she could not continue to run the company by herself. She began to prepare an outline of a plan she wanted to discuss with Chris and Angela which involved them becoming employees of the company.

**CMR, INC. AND FE-LINES**

Chris and Angela were very surprised when Bonnie asked them to become employees of Fe-Lines and essentially develop and implement the marketing plan strategies for the company. After much discussion the two decided that they did not want to give up their company and clients to work full time for Bonnie. In addition, the Rubens had two sons who were actively involved in school and sports and Angela’s schedule provided the flexibility the family needed to balance the needs of the business and the family. Bonnie and the Rubens were able to develop a plan that worked for everyone when it was decided that Fe-Lines would hire the services of CMR for a more limited scope of marketing support activities. Chris would develop a strategic marketing plan for Fe-Lines and lead the establishment of the process by which the product was secured by final users. Angela would help Chris with the research to develop the plan and promote the Fe-Lines products at trade shows. This relationship allowed the flexibility that the Ruben family needed and also allowed Bonnie to secure the primary marketing assistance she needed. CMR was to be paid a monthly consulting fee for the services agreed upon with the understanding that this fee would be renegotiated after six months.

Bonnie, Chris, and Angela were excited that this new relationship was worked out and the Rubens were ready to fully engage in helping Bonnie to continue to move Fe-Lines forward in the market place! When the Rubens returned home they held a meeting to develop a plan of action for their new client. While both were actively engaged in the pet industry, they decided that deeper examination of the cat products marketing was necessary to fully understand the dynamics they were facing. Angela agreed to research this area...
THE PET INDUSTRY AND CAT OWNERSHIP

Angela was familiar with overall pet industry statistics. For example, in the U.S. pet ownership has more than tripled from the 1970s when approximately 67 million households had pets. By 2008-2009, the APPA Pet Owners survey reported that about 68%, or 82.5 million households, own pets. Also, the North American pet industry is a $50 billion dollar a year market. The number of pets owned by Americans is clearly related to the pet size and care requirements; pets that interact with humans, like dogs and cats, are owned in fewer numbers per household than small, contained, “spectator” pets, like fish. However, Angela had to conduct some research to better understand cat owners and their dynamics. She found that cat owners tend to be older than other pet owners. As such, it is likely that, with the graying of America, cat ownership will continue to rise. Nearly 95.6 million cats are currently owned by American households.

Three out of ten (or 34.7 million) U.S. households own at least one cat. One half of cat owning households (46%) own one cat. Cats are more popular than dogs, with over one-half of all pet-owning households (54%) having two cats or more. The recent trend toward living in smaller homes also favors cat ownership. Cat owners tend to own cats for long periods of time. About 70% of respondents have owned cats for six years or more; one third for more than 20 years. As shown in Table 1, cat owners derive many emotional benefits from ownership including companionship, affection, and relative ease of care.
Unlike many other companion animals, cats are self-groomers, do not need to be leashed or contained, and are easily litter-box trained. Cat owners demonstrate their affection for their cats in the form of gifts, treats, and other pampering. Although cat ownership has been steadily rising, the rate of
declawing is declining. Five percent of cat owners purchase repellant and behavior modification products each year. The average annual cat owner spending is shown in Table 2.

Table 2
Cat Owners Average Annual Spending Per Pet*

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food</td>
<td>$165.00</td>
</tr>
<tr>
<td>Vet’s Office</td>
<td>$193.00</td>
</tr>
<tr>
<td>Other Cat Supplies</td>
<td>$48.00</td>
</tr>
<tr>
<td>Grooming</td>
<td>$31.00</td>
</tr>
<tr>
<td>Flea/Tick Products</td>
<td>$26.00</td>
</tr>
<tr>
<td>Treats</td>
<td>$29.00</td>
</tr>
<tr>
<td>Toys</td>
<td>$28.00</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>$520.00</strong></td>
</tr>
</tbody>
</table>

*American Pet Products Association Study Published 2008

The demographic characteristics of cat owners show that as a group they tend to be white, average 44 years of age, married, homeowners and house-dwellers. Sixty percent of this group earns household incomes of $25,000+. Six in ten cat owners keep their cats indoors during the day. At night, the number increases to eight in ten.

STICKY PAWS SITUATION ANALYSIS 2008 – 2009

After Angela concluded her industry research, she and Chris decided it would also be a good idea to prepare a SWOT analysis for the Sticky Paws product as the Rubens began to develop Fe-Lines’ marketing goals, objectives, and strategies for presentation to Bonnie.

Just as Bonnie had found when she started the company in 1997, the two primary competitors were the same: “No Scratch” Aroma Spray by Nala Berry Laboratories and “Boundary” Cat Repellant by Lambert-Kay, division Carter-
Wallace. The aroma spray was composed of water, herb essences, natural emulsifiers and natural biodegradable solvents. The other repellant was an aerosol-based product that used Methy nonyl ketone and related compounds as its active ingredients. Both products retailed for $9.99, however, the aroma spray was in a 12 ounce bottle and the aerosol product was packaged in an 8 ounce can.

The Sticky Paws product profile addresses a specific liability (clawing and shredding) expressed by current and potential cat owners. It is easy to use and fills a product void in the market. At the time they started their association with Bonnie, the product was pre-packed with Clip Strips or in a Counter Display which provided ease of merchandising and the company also provided sales, marketing, and merchandising support. Each retail selling unit consisted of 24 – 2”x12” strips, packaged in a poly bag which included a four-color billboard style insert and header card with a universal product code (UPC).

There are several strengths associated with the product. Sticky Paws is a humane alternative to declawing. It is effective because cats do not like the sticky feeling – they touch it once and don’t go back. This provides both behavior modification and training opportunities. The transparent acrylic adhesive strips are harmless to both felines and furniture. Since the strips are water soluble the strips will not leave a residue and can be easily applied to furniture, stereo speakers, drapes, plants and anywhere else cats shouldn’t be. Sticky Paws brand name is perceived as catchy, self-describing, and affordable at the average retail price of $9.99. In addition, the product can be cross-merchandised in multiple departments and categories within the retail environment (i.e., house wares, furniture & electronics, pet supplies).

Weaknesses include that some may perceive the product simply as double sided tape or that the direct competition of feline declawing removes the need for behavior modification and retraining. Also, there are some limitations to the surfaces that the product can be applied to. Through product testing it was determined that Sticky Paws is not recommended for wood finishes, painted surfaces, leather, vinyl or wallpaper.

Due to the nature of the product there are several publicity opportunities available to urge cat owners to engage in responsible and quality pet ownership. Sticky Paws has received endorsements from the ASPCA (American Society for the Prevention of Cruelty to Animals), and the Humane Society. Further public relations and product testing opportunities still exist.

Threats are few and Angela is concerned that the product and company can grow too fast if not adequately managed. In addition, the product is patent
pending which does not provide protection from potential competitors and could result in potential lawsuits. The company’s brand could be undermined if consumers engage in irresponsible pet ownership or misuse of the product resulting in bad publicity. Finally, a significant threat that Angela believes should be monitored is the state of the economy. Declining economic conditions in 2008 directly negatively impacted expenditures in the pet industry. Sales for *Sticky Paws* fell by about half of the previous year’s sales to $550,000. This caught Bonnie totally off guard as she had not factored economic indicators into her company analysis.

**DEVELOPMENT OF THE MARKETING STRATEGY**

Chris began the development of the marketing strategy that he and Angela would present to Bonnie as Angela concluded her industry and situation analysis for Fe-Lines. He felt the need to formalize the strategy starting with a formal statement of the Mission and Marketing Objectives for the year 2009. The mission will serve as the frame of reference for all decision making and all decisions should be made to support fulfillment of the mission statement: “Fe-Lines’ mission is to develop, produce and professionally market simple yet effective, innovative and well branded pet products that fill market niches and address specific consumer needs”.

He also developed marketing objectives to be achieved over the 12-month period beginning January 1, 2009:

- Increase product distribution to over 2,500 retail stores through aggressive public relations and advertising campaigns, enhanced product merchandising, and “word of mouth” among retailers, cat owners and enthusiasts.
- Raise overall category sales from the projected $500,000 in 2009 to $1,000,000.00.
- Stabilize gross profit margins at 35%.

With this definition of mission and objectives, Chris began to address product, pricing, place and promotion strategies necessary to achieve these objectives. His notes/thoughts for the presentation follow.
Brand Building and Consumer Response

Most cat owners consider their pets family members and shop for products the same way they would for a human family member. They rely on “word of mouth” recommendations from other pet owners and veterinarians, as well as information found in magazines and books. Sticky Paws has and will continue to rely on this type of promotion. Another benefit of using public relations to generate word of mouth promotion is that the retail market place will have to respond to customers’ requests to stock Sticky Paws in their stores. This will eliminate the slotting or implementation fees paid by the manufacturer or marketer to the retailer up front to become the vendor of choice.

Mass promotion through print ad placed in selected trade, enthusiast and general media publications will encourage consumers to order direct from Fe-Lines using the company’s telephone call center which generates 10% of total sales revenue. This is desirable because the product is sold at retail price points, reaping the wholesale and retail margin benefit. Within the first three months, a change will be implemented to raise the average call-in sale from $13.99 to $19.99. The fulfillment costs will only increase by 2% and shipping costs will remain the same. Implementing this change will result in an average net retail selling price through the call center to be $8.38 per unit. The new offer will be as follows: 1-pack of Sticky Paws for $9.99, plus $4.00 S&H; or 2 – packs of Sticky Paws for $19.99, S&H included.

A comprehensive public relations promotion campaign is an important part of the continued emphasis on building brand recognition. Press packs (media kits) including trade and general interest press releases will be developed and target all cat, pet product and cat enthusiast publications and media entities to generate press coverage for Sticky Paws.

Wholesale and Retail Pricing

After Bonnie’s initial pricing problem, Chris was able to reduce the costs of production of the product by outsourcing production to a company in China. This allowed the ideal retail price point for a package of Sticky Paws to be $9.99. Based on Fe-Lines wholesale pricing, this allows a retailer the desired “keystone” markup. In the case of selling to distributors, who in turn sell the product to retail customers, the retail price would jump to $12.99 due to the distributor’s margin requirements. To address this issue Fe-Lines plans to grow
sales either directly to the retailer at $4.95 each, so that they can retail a package at $9.99, or, sell directly to the end customer for $9.99 plus shipping and handling each, via direct mail, internet and mail order sales fulfillment. This pricing strategy provides Fe-Lines a cost/sell markup of 65%. Chris feels this change in the supply chain model is important because the distributor is becoming less and less important to the overall growth prospects of companies. Most regional and national retail chains provide in-house distribution or demand “Direct-Store-Delivery” from the manufacturer. The packaging of the product for retail distribution is already designed to fit most retail environments and can be shipped via UPS, RPS and Federal Express. The 12-count shipper case with Clip Strips included allows the product to be displayed without using costly shelf or peg space. The 24-count counter display merchandising option allows the retailer to position the product right by the register, on shelves, in windows and on top of other bulky products. This display is ideal for the furniture store environment, displayed throughout the showroom and by the credit application and payment centers.

**Other Promotion Considerations**

As Chris reviews his branding and promotional awareness plans, he adds to his notes that he believes it is important to have targeted trade show participation such as the APPMA show where they first met Bonnie. He also feels that the packaging should include a sticker prominently displayed on the front of the package showing the selection of *Sticky Paws* as the Best New Product at the last show. He plans to actively seek out cooperative advertising opportunities with retailers, such as coupon redemption, monthly and quarterly print ads and in-store video demos provided free to customers. In addition he expects that increased public relations will lend more third party validation to product claims made by enthusiastic consumers, retailer, and Fe-Lines.

**Product Line Extension Plans**

Chris realized that for the company to grow, extensions to the product line needed to be developed and marketed. He proposed several variations to the original format of the product, including *Sticky Paws XL* and *Sticky Paws on a Roll*. He also believed that customers who realized the value of behavior modification would also like to purchase something for their cats to use to
sharpen their claws so he proposed a cat scratch pole. He realized that more research and development would be necessary to phase in these products.

THE MEETING WITH BONNIE

Chris and Angela were eagerly anticipating their meeting with Bonnie. They had spent a considerable amount of time preparing the background analysis and marketing plan proposal that they believed would bring Fe-Lines to the best competitive position within the industry. As they drove to Fort Worth, Angela prepared a check list of questions that they wanted to cover before the end of the meeting. They felt confident in their analysis and proposal; however, there was a nagging concern over the patent pending status of the Sticky Paws product. When they initially met Bonnie she shared with them that she had engaged the services of a patent attorney and that a patent pending application including the claims of the product had been filed. However, she had not received any update information from the attorney and no timeline had been provided for securing the patent. Both realized how easy it would be for a competitor to enter the market and directly compete with Fe-Lines should the patent not be granted.

Bonnie enthusiastically received the marketing plan they presented and looked forward to the implementation activities required to grow her business. For the first time in three years, she began to feel confident that her business was going to be a success! She started thinking about her dream to write a book featuring Buddy as the main character before the meeting was even over! The patent issue was not a major concern for her as she believed that she had hired one of the best patent attorneys in Texas as well as the U.S.

Chris and Angela were pleased with Bonnie’s reception of their plan of action and looked forward to many years of affiliation with Fe-Lines, Inc.

FE-LINES, INC.: DON’T DECLAW…GET STICKY PAWS!
INSTRUCTOR’S MANUAL

CASE OVERVIEW ANALYSIS

Fe-Lines, Inc. was founded by Bonnie Pemberton, a broadcast voice over performer. She is an avid cat lover and invented a product, *Sticky Paws*, to modify the behavior of cats that sharpened their claws on furniture, rugs, and other surfaces that they found desirable in the home. Her cat Buddy was the inspiration for the development of *Sticky Paws* because she loved him dearly yet
he had destroyed thousands of dollars of home furnishings and plants. In searching for a solution to his shredding behavior she researched declawing and learned of all of the possible side effects of this procedure. Declawing can lead to infection and inappropriate elimination and Bonnie decided this was not an acceptable solution. This search ultimately led to her development of this double sided adhesive product which can be applied to any surface without leaving sticky residue or otherwise damaging the surface. It is an effective deterrent because cats do not like anything that is sticky on their paws!

At the time Bonnie started selling Sticky Paws, she had no background or experience in business. She was marketing her product at a trade show in Orlando, Florida, when she met Chris and Angela Ruben, who later became the marketing arm of her company. As they watched Bonnie at the trade show they knew that she was really in need of assistance in many aspects from pricing, distribution, and packaging of the product to strategically planning for product line extension. They helped Bonnie initially on a friend/mentor basis and contracted with Bonnie during her second year of operation when she realized she could not run the company by herself.

This case is based upon a real company. A few of the events have been disguised but this does not impact the validity of the case or the teaching objectives.

CASE OBJECTIVES

This case examines the marketing challenges faced by a start-up company in the pet industry. A marketing company is hired to assist the founder and CEO of Fe-Lines, Inc. to help formulate strategies for the marketing mix variables that will position the product in the industry to achieve greatest competitive position. The case takes the reader through the marketing challenges and allows insight into the variety of issues that had to be taken into account before recommendations can be made to the owner. Specific objectives of this case include: (1) discuss Fe-Line, Inc.’s integration of the marketing mix variables; (2) allow students to apply the concepts of market segmentation, targeting, differentiation, and positioning; (3) discuss the importance of the major bases for segmenting the consumer market for pets; (4) examine the impact of segmentation variables on market targeting; and (5) discuss how companies differentiate and position their products for a competitive advantage.
This case would work well in an undergraduate marketing course such as principles, retailing, or marketing research.

STARTING THE DISCUSSION

To get a feel for the pet industry, specifically cat products related to clawing, perform an internet search for Sticky Paws and visit some of the related sites, including a commercial on YouTube (see reference section for link). Next, visit sites that discuss declawing so students have a better understanding of the target market and why cat owners might look for other alternatives to declawing (one link provided in reference section). You should spend some time discussing Sticky Paw’s value proposition and which key messages stand out in the video and on web sites. What makes Sticky Paws different from its competition? What do students notice about the product, competitor products and price?

DISCUSSION QUESTIONS

1. Describe the “four Ps” employed by Fe-Lines, Inc. for Sticky Paws.
   In summary, Sticky Paw’s marketing mix was as follows:

   Product: Sticky Paws is a transparent, odor-less medical grade adhesive that is safe to apply to furniture, countertops, stereo speakers, drapes, carpets or anywhere a cat owner might want to deter their pet from going. The inventor designed the product to be a humane alternative to declawing.

   Price: The price of $9.99 MSRP was set and printed on the packaging.

   Place: Fe-Lines, Inc. sought the expertise of marketing consultants to help sell their product to national pet industry retailers, such as Petco. The product was also sold through additional channels including telephone sells and eventually online.

   Promotion: Sticky Paws primarily relied on appearances at trade shows and some limited advertising. The product was shipped in 12-count point-of-purchase (POP) displays and 24-count counter displays to allow maximum visibility and reduce the need for shelving allowances.

2. Specifically considering the mix variable of price, has Fe-Lines Inc. executed cost-based pricing or competition-based pricing? Explain.
Fe-Lines Inc. followed a competition-based pricing upon which they set prices based on competitors’ strategies, costs, prices, and market offerings. Consumers tend to base their conclusions of a product’s value on the prices that competitors charge for similar products. However, it should be noted that Sticky Paws was different than the “spray” products it was compared to in the pet industry. Thus, it could be argued that Sticky Paws was a superior product that offered more value to the customer.

Cost-based pricing involved setting prices based on the cost for producing, distributing, and selling the product, plus a fair rate of return for the seller.

3. How was Fe-Lines, Inc. able to support their pricing strategy once it was realized that they would not make money at the current price?

Fe-Lines, Inc. had to find a way to support their current pricing strategy as packaging had already been manufactured with a $9.99 MSRP label. Since Fe-Lines, Inc. could not afford to reprint packaging they would have to look at one of the remaining Ps, place. Fe-Lines, Inc. was able to locate a manufacturer in China that could produce Sticky Paws for less than the American-based company. The savings in manufacturing could be passed down the channel, allowing Felines, Inc. and other channel members to remain profitable and sustain the suggested MSRP.

4. What is the one most significant issue in the legal environment, and how did it impact marketing activities?

The patent pending status of the Sticky Paws product turned out to be one of the most critical issues that the company faced. After the patent attorney for Fe-Lines, Inc. filed the patent application for Sticky Paws with the U.S. Patent Office, ten years lapsed before the product claims in the application were reviewed and the patent examiner ultimately denied the application. During the review process the examiner committed an actionable mistake which allowed the patent attorney to file another patent application for the Sticky Paws on a Roll product. The same claims in addition to others were the basis for this application. The process had taken so long that a couple of competitors decided it was worth the risk to develop and sell generic brands of the Sticky Paws products. These competitors began to take market share away for Fe-Lines, Inc. and the marketing plan emphasis had to be expanded to differentiate Sticky Paws from the generic providers.
Ultimately the patent applied for in the second application was granted. However by the time the patent was approved, Bonnie had spent a quarter of a million dollars ($250,000) to secure the patent and had sold the company three months before the patent application was approved. She had lost hope that the patent would be granted and had run out of money to continue to pursue the patent process. The initial supplier of the product in the United States had approached her about a year before she sold the company with an offer to purchase the company. Bonnie and the Rubens had cut the operation costs as much as they could and CMR Marketing was being paid a reduced consulting fee during this time so that the company could continue to operate. Needless to say, the news that the patent had been granted so soon after the company was sold was very distressing to Bonnie, Chris, and Angela.

If Bonnie had still owned Fe-Lines, Inc. at the time the patent was granted, her patent attorney would have given notice to all of the other producers of the generic products directly competing with the Sticky Paws product a notice of acceptance of the patent application. Details would have to be worked out regarding the disposition of any inventory that the competitors currently held at the time the patent was granted and the producers would no longer legally be allowed to produce the product.

The flowchart (source: http://www.inventorbasics.com/Patent%20Process.htm) illustrates the examination process for a patent application at the U.S. Patent Office. While the applications are usually processed quickly, it can take many years (i.e. 10 years for Fe-Lines, Inc.) for the application to be examined and a final decision made by the examiner assigned to the application.
5. How would you describe Fe-Lines, Inc.’s approach to market segmentation?

Market segmentation was one variable that helped Fe-Lines, Inc. in designing a customer-driven marketing strategy that built the right relationships with the right customers. Figure 1 illustrates the four major steps in designing a customer-driven marketing strategy that builds the right relationships with the right customers.

**Figure 1: Designing a Customer-Driven Marketing Strategy**

Demographic Segmentation

Demographic segmentation is one way Fe-Lines, Inc. can split the market into groups. Variables that the company could consider would include age, gender, family life cycle, income, occupation, education, generation, and nationality. According to the American Pet Products Association, in 2014 there were over 95 million owned cats in approximately 45 million households. Marketers for Sticky Paws must determine which bases of demographic segmentation will most effectively aid them in segmenting customers.

Psychographic Segmentation

Psychographic segmentation divides buyers into different groups based on social class, lifestyle, or personality characteristics. In addition, marketers also use personality variables to segment markets. Research suggests that psychographic bases of segmentation can provide insight into how cat owners think.
Behavioral Segmentation

Behavioral segmentation divides buyers into groups based on their knowledge, attitudes, uses, or responses to a product. Fe-Lines, Inc. employed benefit segmentation by grouping buyers according to the different benefits that they sought in purchasing Sticky Paws. Consumer benefits sought could include behavior modification for scratching, clawing, and improper elimination. Fe-Lines, Inc. could also segment markets by user status (first-time users, regular users, etc.) and usage rate (light, medium, heavy product users).

6. Consider yourself as a cat owner in need of a way to control cat scratching behavior. Do you think you fall into the category of declaw or not to declaw? Discuss whether the product meets the requirements for effective segmentation in market substantiality?

Students should recall the discussion at the beginning of class that included both sides of the declaw/do not declaw issue. Effective segmentation requires that the market segments be: measureable, accessible, substantial, differentiable, and actionable. Specifically, Fe-Lines, Inc. had to determine if the market segment of cat owners that choose not to declaw or would use the product for inappropriate elimination was large or profitable enough to serve. Since Sticky Paws could also be used as a behavior modification for inappropriate elimination the segment could be expanded and its substantiality increased.

7. Recall the slogan from the commercial, “It takes the “Ow!” out of Meow!” What does it mean, and how is it central to Sticky Paw’s segmentation strategy?

As with most marketers, Fe-Lines, Inc. uses a combination of different segmentation variables. Sticky Paw’s slogan is central to the behavioral segmentation base and more specifically, benefit segmentation. Sticky Paws offers several different benefits to the consumer, including behavior modifications for scratching, destroying furniture and plants, and inappropriate elimination. As a class, you can begin to discuss how these variables relate to Fe-Lines, Inc.’s market targeting. The company had to decide if they should target very broadly (undifferentiated marketing), very narrowly (micromarketing), or someplace in between (differentiated or concentrated marketing). Fe-Lines, Inc. used an undifferentiated marketing strategy and
targeted the entire market with one offer. The strategy focused on the shared need of behavior modification for both clawing and inappropriate elimination in an effort to appeal to the largest number of consumers.


Differentiating and positioning requires a company to: (1) identify a set of differentiating competitive advantages to build their position on; (2) choose the right competitive advantages; and (3) select an overall positioning strategy. Fe-Lines, Inc. differentiated along the lines of product and image. The company was able to provide superior customer value by providing a product that humanely deterred cats from clawing and inappropriately eliminating on furniture and other household items. The difference that Fe-Lines, Inc. chose to promote was important to buyers, distinctive, superior to sprays that could damage furniture or the risk of declawing, communicable and visible to buyers, affordable, and profitable.

Fe-lines, Inc.’s value proposition included a “More for the same” positioning as it communicated the high quality and humane benefits of Sticky Paws at the same price as competing products in the market.

9. Is Bonnie Pemberton an inventor and an entrepreneur? Explain?

This question may be used at the faculty member’s discretion. It is designed to stimulate discussion among the students regarding the difference between inventors and entrepreneurs. Many times inventors develop a good solution to a consumer problem but are not able to launch the business. Some inventors like to develop great ideas and find intrinsic value in the process. The major factor distinguishing an inventor from an entrepreneur is action. Stacks of great ideas generated by inventors are irrelevant to entrepreneurs. Successful entrepreneurs have to be flexible and have a willingness to act. This case illustrates the difficulties Bonnie experienced leading to her invention as well as the actions she took to launch her product in the market place. Her recognition of her lack of marketing expertise and her willingness to hire this capability is another characteristic of an entrepreneur.
REFERENCES


Retrieved from https://www.youtube.com/watch?v=iNhjtH-Qual
Retrieved from http://www.americanpetproducts.org/

EPILOGUE

The Rubens and Bonnie established a close working relationship. Chris embraced the challenge of implementing the marketing plan they had developed but actual sales of $750,000 did not meet his objective. It is important to note though that actual sales did exceed projected sales for 2009. Economic recovery during this time period was slow and there was lingering uncertainty in consumers’ minds regarding spending. Another complicating factor which contributed to a lower sales level than Chris expected was the patent situation. Since a patent pending status does not prohibit others from producing similar products, by 2009 some of the larger retailers decided to order a version of the generic product rather than stock the original *Sticky Paws*. They were willing to take the risk that the patent would be approved and they would have to discontinue stocking the generic product.

Sales for 2010 increased almost $100,000 to $849,000. Bonnie and the Rubens were working developing creative marketing mix strategies that would
return the level of sales to the $1,100,000 mark. By the end of 2010 Bonnie was reluctant to invest more of her personal funds into the company and she implemented cost cutting measures including reducing the number of hours her office assistant/bookkeeper worked per week. The Rubens also accepted a temporary reduced consulting fee for their services to help Fe-Lines, Inc. through this tough financial performance period.

The fees for the patent attorney became a drain on the company and although Bonnie funded the second patent application, she did not believe that a patent would ever be approved. She was weary of the process and expense after all of the years she waited for a favorable ruling from the patent examiner.

Chris and Angela were impacted by the reduction in the Fe-Lines, Inc. consulting fee and they had to establish contracts with other companies to provide the level of income they needed to support their family and grow their business. These new commitments required investment of time which reduced the time available to devote to Bonnie and the company. Bonnie had become heavily dependent on Chris and his lack of ability to immediately respond to her further stressed her.

After a series of conversations, Bonnie made the decision for Chris to lead the negotiations to sell the company. An agreement was made which included the selling price and an agreement for Chris to remain with the new owner as a consultant for a transition period of six months. Three months after the company sold, the patent examiner approved the second patent application.

Bonnie finished the book that she was writing where Buddy is the main character, *The Cat Master*. CMR has engaged in contractual agreements with other companies operating in the pet industry to perform various marketing support functions. In addition, Chris and Angela have started their own company designed to raise funding for animal shelters and support groups. Adopt-A-Shelter is a virtual shopping mall based on a unique business model and is beginning the second year of operation.