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2

SMALL BUSINESS MANAGEMENT AND ENTREPRENEURSHIP

LEARNING OUTCOMES

After reading this chapter, you should be able to

- 2.1 Articulate the differences between the small business manager and the entrepreneur.
- 2.2 Discuss the steps in preparing for small business ownership.
- 2.3 Enumerate the advantages and disadvantages of self-employment.
- 2.4 Explain the role of innovation to small business.

Entrepreneurs solve problems. That's really what they do—they identify problems and create a business to solve them. So, when's a good time to start solving problems? How about now?

You've heard stories of many famous entrepreneurs who dropped out of college to start their wildly successful business, insert Mark Zuckerberg or Steve Jobs story here. But you don't have to drop out to start a business.

Meet Ben. Ben Pasternak started his company Nuggs in 2019 when he was 18 years old. Pasternak had two passions in his life—technology and chicken nuggets. He had seen a problem of technology resistance in the food industry, so he wanted to bridge that gap by creating a plant-based, alternative meat product. Ben states "People universally like chicken nuggets, but it's also universally agreed that whatever is in them is probably not so great." Getting funding for Nuggs was less difficult than usual since he has startup experience developing software and apps. When he was 13, he developed a game called Impossible Rush which peaked at number 16 on US App Store (above Tinder and Twitter). At age 15, he became one of the youngest to receive venture capital investment for a tech company, Flogg social networking app for young people to buy and sell. Nuggs generated \$8 million of revenue in 2021 and has brought in over \$50 million in funding to date.

Meet Jamie. Entrepreneurs look for problems to solve. Jamie Steenbakkers found one as a college freshman—how long it takes to get ready to go out for the evening. She and classmate Michael Leahy looked at disposable wipes as great tools to freshen up, but they learned that they are not so great for the environment. The pair was shocked to find that 90% of wipes on the market contained plastic that does not biodegrade and ends up in our oceans. In the United States alone, 60 billion wipes are used each year adding up to disturbing effects. They created Busy Co. which makes a variety of wipes from upcycled fabric and all-renewable energy. Busy Co. has generated over \$2 million in revenue and raised more than \$3 million in funding.

Sources: Chloe Arrojado, "The Future is Bright—Ben Pasternak," *Entrepreneur*, September 2021, p. 43; Wikipedia, Ben Pasternak, accessed September 2022, https://en.wikipedia.org/wiki/Ben_Pasternak; Forbes Under 30—Ben Pasternak, November 30, 2021, www.forbes.com/profile/ben-pasternak; Emily Rella, "The Future is Bright—Jamie Steenbakkers," *Entrepreneur*, September 2021, p. 44; MeiMei Fox, "Busy Brand Is Cleaning Up Wipes by Making Them Eco-Friendly," *Forbes*, March 27, 2021, <https://www.forbes.com/sites/meimeifox/2021/05/27/busy-brand-is-cleaning-up-wipes-by-making-them-eco-friendly>

CONCEPT MODULE 2.1: THE ENTREPRENEUR–MANAGER RELATIONSHIP

What is the difference between a small business manager and an entrepreneur? Aren't all small business owners also entrepreneurs? Don't all entrepreneurs start as small business owners? The terms are often used interchangeably, and although some overlap exists between them, there are enough differences to warrant studying them separately.

In fact, entrepreneurship and small business management are both *processes*, not isolated incidents. **Entrepreneurship** is the process of identifying opportunities for which marketable needs exist and assuming the risk of creating an organization to satisfy them. An entrepreneur needs the vision to spot opportunities and the ability to capitalize on them. **Small business management**, by contrast, is

the ongoing process of owning and operating an established business. A small business manager must be able to deal with all the challenges of moving the business forward—hiring and retaining good employees, reacting to changing customer wants and needs, making sales, and keeping cash flow positive, for example.

The processes of entrepreneurship and small business management both present challenges and rewards as the business progresses through different stages.



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What Is an Entrepreneur?

An entrepreneur is a person who takes advantage of a business opportunity by assuming the financial, material, and psychological risks of starting or running a company. The risks that go with creating an organization can be financial, material, and psychological. The term *entrepreneur*, a French word that dates from the 17th century, translates literally as “between-taker” or “go-between.”¹ It originally referred to men who organized and managed exploration expeditions and military maneuvers. The term has evolved over the years to have a multitude of definitions, but most include the following behaviors:

- *Creation.* A new business is started.
- *Innovation.* The business involves a new product, process, market, material, or organization.
- *Risk assumption.* The owner of the business bears the risk of potential loss or failure of the business.
- *General management.* The owner of the business guides the business and allocates the business’s resources.
- *Performance intention.* High levels of growth and/or profit are expected.²

All new businesses require a certain amount of entrepreneurial skill. The degree of entrepreneurship involved depends on the amount of each of these behaviors that is needed. Current academic research in the field of entrepreneurship emphasizes opportunity recognition, social capital, and trust.

Entrepreneurship and the Small Business Manager

Entrepreneurship involves the start-up process. Small business management focuses on running a business over a long period of time and may or may not involve the start-up process. Although you cannot study one without considering the other, they are different. In managing a small business, most of the “entrepreneurship” was done a long time ago. Of course, a good manager is always looking for new ways to please customers, but the original innovation and the triggering event that launched the business make way for more stability in the maturity stage of the business.

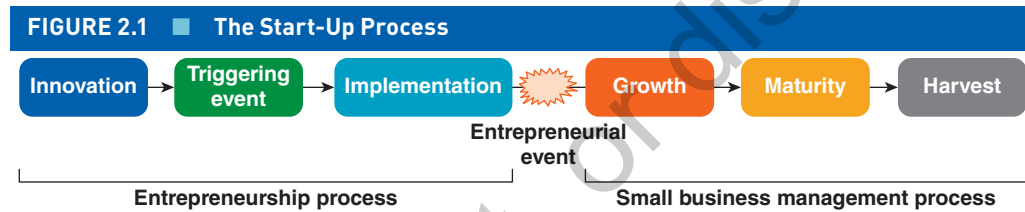
The manager of a small business needs perseverance, patience, and critical-thinking skills to deal with the day-to-day challenges that arise in running a business over a long period of time.

Concept Check Questions

1. What do entrepreneurs do that distinguishes them from other persons involved in business?
2. Imagine that the principal from the high school you attended called to invite you to make a presentation to a newly founded entrepreneurship club at the school. What would you tell this group of high school students about owning their own business as a career option?

CONCEPT MODULE 2.2: A MODEL OF THE START-UP PROCESS

The processes of entrepreneurship and small business management can be thought of as making up a spectrum that includes six distinct stages (Figure 2.1).³ The stages of the entrepreneurship process are innovation, a triggering event, and implementation. The stages of the small business management process are growth, maturity, and harvest.



The **entrepreneurship process** begins with an *innovative idea* for a new product, process, or service, which is refined as you think it through. You may tell your idea to family members or close friends to get their feedback as you develop and cultivate it. You may visit a consultant at a local small business development center for more outside suggestions for your innovative business idea. Perhaps you even wake up late at night thinking of a new facet of your idea. That is your brain working through the creative process subconsciously. The time span for the innovation stage may be months or even years before the potential entrepreneur moves on to the next stage. Usually a specific event or occurrence sparks the entrepreneur to proceed from thinking to doing—a **triggering event**.

When a triggering event occurs in the entrepreneur's life, they begin bringing the organization to life. This event could be the loss of a job, the successful gathering of resources to support the organization, or some other factor that sets the wheels in motion.

Implementation is the stage of the entrepreneurial process in which the organization is formed. It can also be called the *entrepreneurial event*.⁴ Risk increases at this stage of the entrepreneurial process because a business is now formed. The innovation goes from being just an idea in your head to committing resources to bring it to reality. The commitment needed to bring an idea to life is a key element in entrepreneurial behavior. Implementation involves one of the following: (1) introducing new products, (2) introducing new methods of production, (3) opening new markets, (4) opening new supply sources, or (5) industrial reorganization.⁵

Entrepreneurship is, in essence, the creation of a new organization.⁶ By defining entrepreneurship in terms of the organization rather than the person involved, we can say that entrepreneurship ends when the creation stage of the organization ends. This is the point where the **small business management process** begins. The rest of this book will concentrate on the process of managing a small business from growth through harvest.

The small business manager guides and nurtures the business through the desired level of **growth**. The growth stage does not mean that every small business manager is attempting to get their business to Fortune 500 size. A common goal for growth of small businesses is to reach a critical mass, a point at which an adequate living is provided for the owner and family, with enough growth remaining to keep the business going.

The **maturity** stage of the organization is reached when the business is considered well established. The survival of the business seems fairly well assured, although the small business manager will still face many other problems and challenges. Many pure entrepreneurs do not stay with the business until this stage. They have usually moved on to other new opportunities before this point is reached. Small business managers, by contrast, are more committed to the long haul.

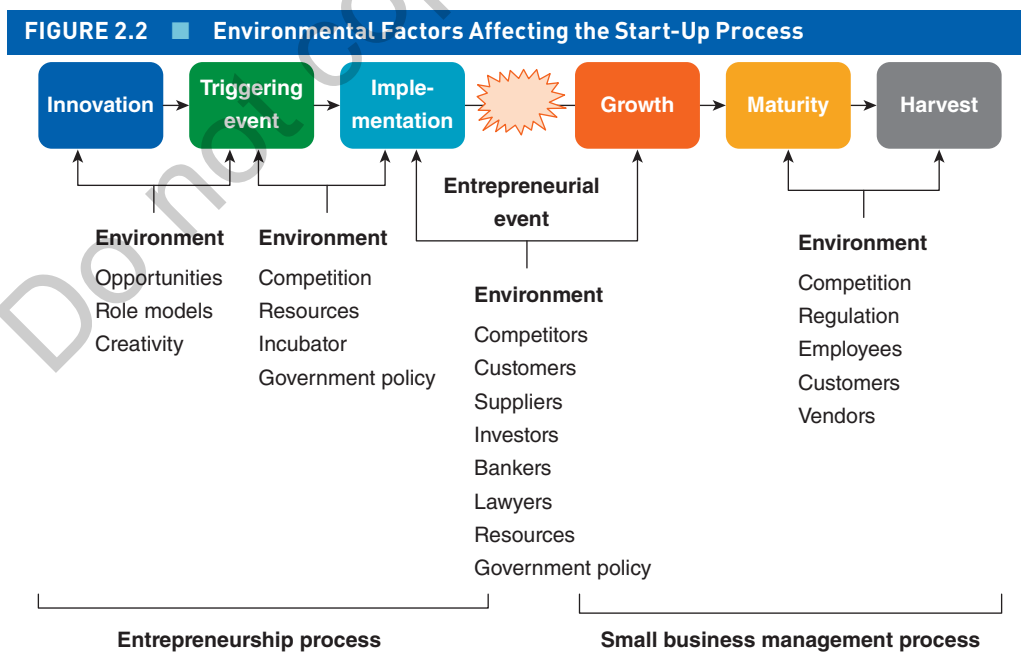
This stage could be as short as a few months (in the case of a fad product) or as long as decades. Maturity in organizations can be similar to maturity in people and in nature. It is characterized by more stability than that of the growth and implementation stages. Of course, organizations should not become too complacent or stop looking for new ways to evolve and grow, just as people should continue learning and growing throughout their lives.

In the **harvest** stage, the owner removes themselves from the business. Harvesting a business can be thought of as picking the fruit after years of labor. In his book *The 7 Habits of Highly Effective People*, Steven Covey says one of the keys to being effective in life is “beginning with the end in mind.”⁷ This advice applies to effectively harvesting a business also. Therefore, it is a time that should be planned for carefully.

The harvest can take many forms. For example, the business might be sold to another individual who will step into the position of manager. Ownership of the business could be transferred to its employees via an employee stock ownership plan (ESOP). It could be sold to the public through an initial public offering (IPO). The business could merge with another existing business to form an entirely new business. Finally, the harvest could be prompted by failure, in which case the doors are closed, the creditors paid, and the assets liquidated. Although made in a different context, George Bernard Shaw’s statement, “Any darned fool can start a love affair, but it takes a real genius to end one successfully,” can also apply to harvesting a business.

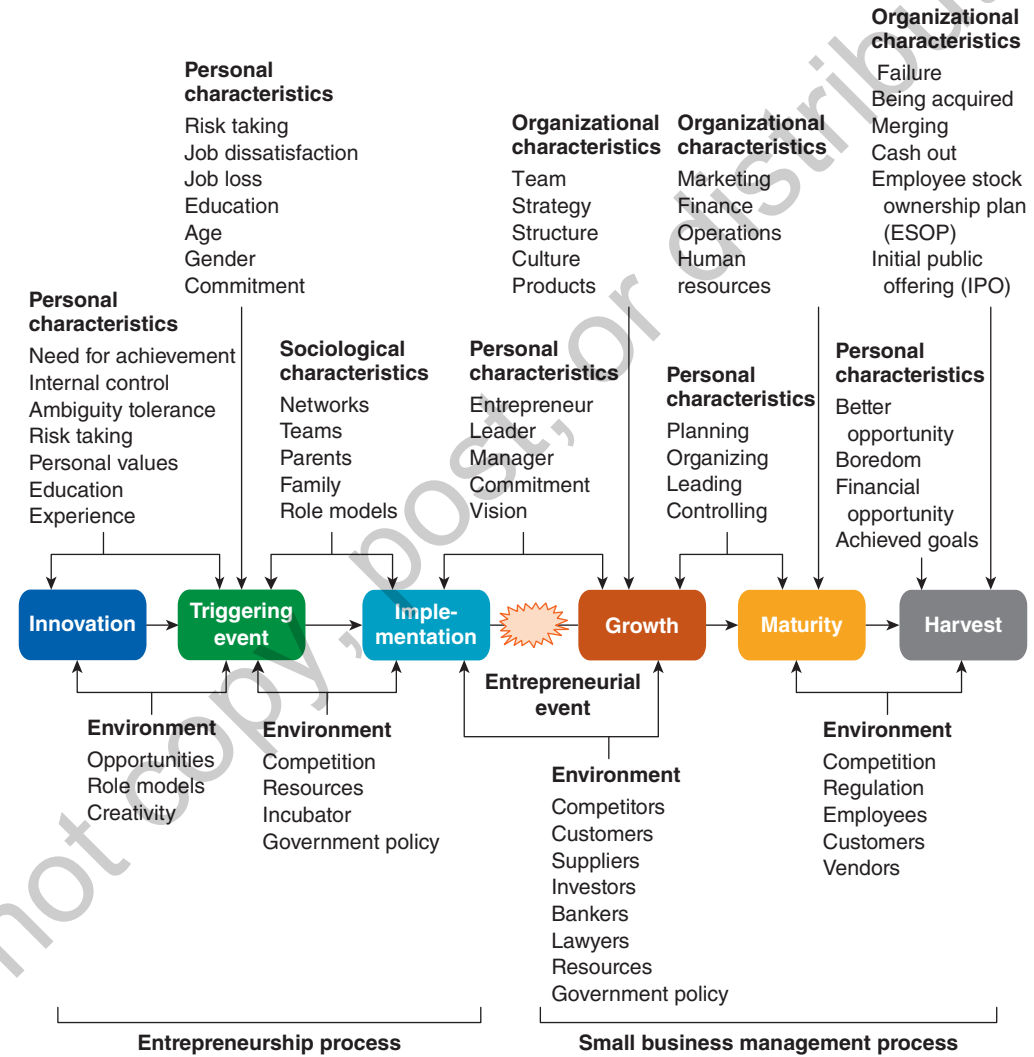
Not every business reaches all of these stages. Maturity cannot occur unless the idea is implemented. A business cannot be harvested unless it has grown.

Figure 2.2 adds **environmental factors** to our model to show what is going on outside the business at each stage of development. Management guru Peter Drucker points out that innovation occurs as a response to opportunities within several environments.⁸ For example, other entrepreneurs might serve as role models when we are in the innovation and triggering-event stages. Businesses in the implementation and growth stages must respond to competitive forces, consumer desires, capabilities of suppliers, legal regulations, and other forces. The environmental factors that affect the way in which a business must operate change from one stage to the next.



The personal characteristics of the entrepreneur or the small business manager that are most significant in running a business will vary from one stage to the next. As you will see in the next section, personal characteristics or traits are not useful in predicting who will be a successful entrepreneur or small business manager, but they do affect the motivations, actions, and effectiveness of those running a small business (Figure 2.3). For example, in the innovation and triggering-event stages, a strong need to achieve, a high tolerance for ambiguity, and a willingness to accept risk are important for entrepreneurs. In the growth and maturity stages, the personal characteristics needed to be a successful small business manager are different from those needed to be a successful entrepreneur. In these stages, the small business manager needs to be persevering, committed to the long run of the business, a motivator of others, and a leader.

FIGURE 2.3 ■ A Model of the Entrepreneurship/Small Business Management Process



Source: Based on, with additions to, Carol Moore, "Understanding Entrepreneurial Behavior: A Definition and Model," in *Academy of Management Best Paper Proceedings*, edited by J. A. Pearce II and R. B. Robinson, Jr., 46th Annual Meeting of the Academy of Management, Chicago, 1989, 66-70. See also William Bygrave, "The Entrepreneurial Paradigm (I): A Philosophical Look at Its Research Methodologies," *Entrepreneurship: Theory and Practice*, Fall 1989, 7-25.

The business also changes as it matures. In the growth stage, attention is placed on team building, setting strategies, and creating the structure and culture of the business. In the maturity stage, more attention can be directed to specific functions of the business. The people within the business gravitate toward, specialize in, and concentrate on what they do best, whether it's marketing, finance, or managing human resources.

The purpose of the entrepreneurship and small business management model is to illustrate the stages of both processes and factors that are significant in each. The purpose of this book is to assist you as you proceed from the innovation stage through the management of your successful business to a satisfying harvest.

Concept Check Questions

1. Describe the significance of triggering events in entrepreneurship. Give examples.
2. How is small business management different from entrepreneurship?
3. Why would an entrepreneur be concerned about harvesting a business that has not yet been started?

CONCEPT MODULE 2.3: YOUR DECISION FOR SELF-EMPLOYMENT

Readers of this text are probably considering the prospect of starting their own business now or at some time in the future. To help you decide whether owning a small business is right for you, we will consider some of the positive and negative aspects of self-employment. Then we will look at the reasons why other people have chosen this career path, what they have in common, and what resources they had available. Finally, we will address the issue of how you can prepare yourself for owning a small business.

Pros and Cons of Self-Employment

Owning your own business can be an excellent way to satisfy personal as well as professional objectives. Before starting your own business, however, you should be aware of the drawbacks involved as well as the payoffs. We will discuss the advantages first, such as the opportunity for independence, an outlet for creativity, a chance to build something important, and rewards in the form of money and recognition (see Figure 2.4).

FIGURE 2.4 ■ Small Business Owners Are Driven by a Variety of Motives

- Control Your Destiny
- Achieve Work/Life Balance
- Choose Who You Work With
- Take on Risk While Reaping Rewards
- Challenge Yourself
- Follow Your Passion
- Achieve Things Faster
- Connect With Clients
- Give Back to Community
- Pride in Building Something You Own

Source: "11 Benefits of Self-Employment," indeed, June 16, 2021, <https://www.indeed.com/career-advice/finding-a-job/benefit-of-self-employment>

Opportunity for Independence

To many people, having their own business means having more control over their lives. They feel that they cannot reach their full potential working for someone else. Business ownership seems to offer a way to realize their talents, ambitions, or vision. This search for independence has led many people to leave jobs with large corporations and strike out on their own.



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Opportunity for a Better Lifestyle

The desire to use one's skills fully is the most common motivation for self-employment. The idea is to provide a good or service that other people need while enjoying what you do. The lifestyle provided by owning your own business can make going to work fun. Working becomes a creative outlet that gives you the opportunity to use a combination of your previously untapped talents.

Also attractive to most entrepreneurs is the challenge presented by running their own business. Such people are often bored working for someone else. As a business owner, the only limitations you face arise from a challenge to your own perseverance and creativity, not from barriers placed before you by other people or the constraints of an organization.

About half of small business owners are motivated by familial concerns (refer again to Figure 2.4). They may feel not only that self-employment is the best way to provide for their children now, but also that their business is a legacy for their children. Children, in turn, may enter the family business out of self-interest or to help ease their parents' burden.

Opportunity for Profit

Less than 20 percent of small business owners express a desire to earn lots of money. Most people do not start businesses to get rich, but rather to earn an honest living. Nonetheless, the direct correlation between effort and compensation is a powerful motivation to work hard. The fact that you can keep all the money you earn is a strong incentive for many entrepreneurs.

Risks of Self-Employment

Small business ownership offers ample opportunities to satisfy your material and psychological needs, but it also poses certain risks of which you should be aware. Personal liability, uncertain income, long working hours, and frequently limited compensation while the business grows are some of the disadvantages of self-employment. Moreover, not having anyone looking over your shoulder may leave you with fewer places to turn for advice when the going gets tough. And even though you are your own boss, you are still answerable to many masters: You must respond to customer demands and complaints, keep your employees happy, obey government regulations, and grapple with competitive pressures.

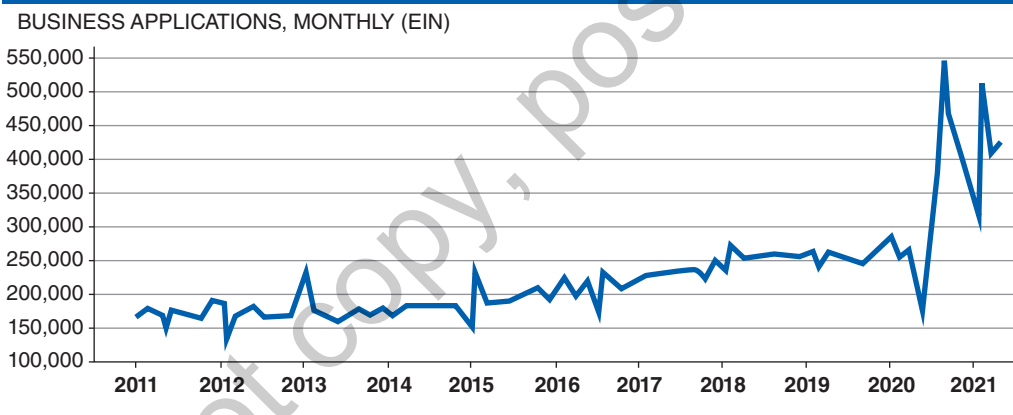
The uncertainty of your income is one of the most challenging aspects of starting a business. There is no guaranteed paycheck at the end of the pay period, as exists when you are working for someone else. Your young business will require you to pump any revenue generated back into it. As the owner, you will be the last person to be paid, and you will probably have to live on your savings for a while. Going through the first year of business without collecting a salary is common for entrepreneurs.



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Some risks are not foreseeable, such as a global pandemic. Not every event can be planned for, so small businesses must be ready to quickly respond and pivot in order to survive. An interesting response to the pandemic—the risks did not deter many Americans from starting their own business. Applications for Employer Identification Number (EIN) are a good indicator of the number of new start-ups. Despite a short dip in 2020, there was soon a dramatic spike in EIN applications in 2021 (see Figure 2.5).

FIGURE 2.5 ■ Employer Identification Number Applications



Source: World Economic Forum, "34% of America's small businesses are still closed due to COVID-19," May 5, 2021, <https://www.weforum.org/agenda/2021/05/america-united-states-covid-small-businesses-economics/>

The reliable, if dull, nine-to-five work schedule is another luxury that small business owners must do without. To get your business off the ground during the critical start-up phase, you may find yourself being the company president during the day and its janitor at night. Owning and running a business requires a tremendous commitment of time and effort. You must be willing to make sure everything that must be done actually gets done. In a study conducted by the Families and Work Institute, among the 3,500 small business respondents, 43 percent worked more than 50 hours per week, while 38 percent worked between 35 and 50 hours per week. (The same study also showed those same small business owners earned an average of \$112,800 per year—so there *is* a payoff!)⁹

When you own a business, it becomes an extension of your personality. Unfortunately, it can also take over your life, especially at the beginning. Families, friends, and other commitments must sometimes take a backseat to the business. This problem is complicated by the fact that people often start businesses in their child-rearing years. Married couples going into business together face a volatile mix of business and marital pressures that do not always lead to happy endings.

The Balance of Life in Small Business

Have you thought about, dreamed of, planned for work–life balance that you would create for your future small business? You're not alone—that mythical balance is a hot button for aspiring entrepreneurs. The problem is that it's more “myth” than “balance.”

Fortunately, the topic of work–life balance is one of semantics and personal definitions. People who define work–life balance as having the “perfect” business that transitions into the “perfect” life are setting themselves up for disappointment due to unrealistic definitions and expectations.

Owners of small businesses get pulled in many directions because they are responsible for every facet of the business. Author Annie McKee states, “We tell ourselves that if we just ‘meet this deadline,’ get through the busy period or reach that next goal, *then* we will take care of ourselves. *Then*, we will have balance.” All areas of life are about choices and true 50–50 balance seldom occurs because there are always new goals (both personal and professional), new deadlines, new passions.

What will likely work better for you is to work on optimizing work–life *integration*, rather than *balance*. Finding how you can best blend your desires to engage with your business, your family, your friends, your health, and your community is more realistic than truly making such areas “balance.” We have a lot of moving pieces that are not the same size or importance but are all necessary for life to work. How can we do that?

Connect. Small business owners are seldom “lone wolves.” We operate best by having personal connections at our business, with our families, in our communities, so connect and be sure to listen to the people we are connected to. They will provide feedback to us when one area of our life is taking over (even before we realize it ourselves).

Create multitiered support systems. When you are living an integrated lifestyle, you need to be open to receive help from each area.

Get healthy. Exercise and sleep are critical to staying healthy, and the health of a small business owner is closely tied to the health of their business.

Practice tactical imbalance. As stated earlier, balance doesn't have to mean exactly equal. It's OK to go out of balance in certain areas while still remaining committed to everything. Just be aware of the imbalance and recover when you can.

Combine your commitments with prioritization. Starting and running a small business takes a lot of time. Period. Few people have ever had the conscious thought that their family is not their highest priority, but there are always sacrifices to achieve commitments in every area.

Traits of Successful Entrepreneurs

Since the early 1960s, researchers have tried to identify the personal characteristics that will predict those people who will be successful entrepreneurs. The conclusion of more than 30 years of research is that successful entrepreneurs cannot be predicted. They come in every shape, size, and color, and from all backgrounds. Still, in this section we will briefly examine some characteristics seen among individuals who tend to rise to the top of any profession. The point to remember when you are considering starting a business is that no particular combination of characteristics guarantees success. People possessing all the positive traits discussed here have experienced business failure. However, certain qualities seem to be prerequisites of success.

First, you need to have a *passion* for what you are doing. Caring very deeply about what you are trying to accomplish through your business is imperative. If you go into business with a take-it-or-leave-it, it-will-go-or-it-won't attitude, you are probably wasting your time and money. *Determination* is also critical. You must realize that you have choices and are not a victim of fate. You need to believe that you can succeed if you work long enough and hard enough. *Trustworthiness* is important to entrepreneurs because of their many interpersonal, institutional, or organizational relationships (often untested) under conditions of uncertainty.¹⁰ Finally, you need a deep *knowledge* of the area in which you are working. Your customers should see you as a reliable source in solving their wants and needs. Virtually every

successful entrepreneur possesses these four characteristics of passion, determination, trustworthiness, and knowledge.¹¹ In other words, perseverance, the technical skills to run a business, belief in yourself, and the ability to inspire others to trust you are all important for success.

A pioneer in entrepreneurial research, David McClelland identified entrepreneurs as people with a higher **need to achieve** than nonentrepreneurs.¹² People with a high need to achieve are attracted to jobs that challenge their skills and problem-solving abilities, yet offer a good chance of success. They equally avoid goals that seem almost impossible to achieve and those that pose no challenge. They prefer tasks in which the outcome depends on their individual effort.

Locus of control is a term used to explain how people view their ability to determine their own fate. Entrepreneurs tend to have a stronger internal locus of control than people in the general population.¹³ People with a high internal locus of control believe that the outcome of an event is determined by their own actions. Luck, chance, fate, or the control of other people (external factors) are less important than one's own efforts.¹⁴ When faced with a problem or a difficult situation, internals look within themselves for solutions. Internal locus of control is the force that compels many people to start their own businesses in an effort to gain independence, autonomy, and freedom.

Successful entrepreneurs and small business owners are innovative and creative. *Innovation* results from the ability to conceive of and create new and unique products, processes, or services. Entrepreneurs see opportunities in the marketplace and visualize creative new ways to take advantage of them.

How do entrepreneurs tend to view *risk taking*? A myth about entrepreneurs is that they are wild-eyed, risk-seeking, financial daredevils. While acceptance of financial risk is necessary to start a business, the prototypical entrepreneur tends to accept moderate risk only after careful examination of what they are about to get into.

Consider the case of Scott Schmidt, the entrepreneurial athlete who started what has become known as “extreme skiing.” Basically, he jumps from 60-foot cliffs on skis for a living. Ski equipment companies sponsor him for endorsements and video production. If you saw him from the ski lift, you would say, “That guy is a maniac for taking that risk.” The same is often said of other entrepreneurs by people looking in from outside the situation. Actually, Schmidt very carefully charts his takeoff and landing points, and he does not see himself as reckless. An analogy can be drawn between Schmidt's adventurous style of skiing and the risks of starting a new business.

Entrepreneurs carefully plan their next moves in their business plans. Once they are in the air, entrepreneurs must trust their remarkable talent to help them react to what comes their way as they fall. Entrepreneurs don't risk life and limb because they look for ways to minimize their risks by careful observation and planning, just as Schmidt precisely plans his moves. They commonly do not see unknown situations as risky, because they know their strengths and talents, are confident of success, and have analyzed the playing field. In similar fashion, Scott Schmidt doesn't consider himself reckless. He considers himself very good at what he does.¹⁵ That is a typical entrepreneurial attitude.

Other traits that are useful in owning your own business are a high level of energy, confidence, an orientation toward the future, optimism, a desire for feedback, a high tolerance for ambiguity, flexibility/adaptability, and commitment. If one characteristic of successful entrepreneurs stands out above all others across all types of businesses, however, it would have to be their *incredible tenacity*.

Preparing Yourself for Business Ownership

How do you prepare for an undertaking like owning your own business? Do you need experience? Do you need education? The answer to the latter two questions is always “yes.” But what kind? And how much? These questions are tougher to answer because their answers depend on the type of business you



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plan to enter. The experience you would need to open a franchised bookstore differs from that needed for an upscale restaurant.

Entrepreneurs and small business owners typically have higher education levels than the general public. About 39.2 percent of new business owners have a bachelor's degree compared to 29.2 percent for the general population.¹⁶ Exceptions do exist, however—people have dropped out of school and gone on to start successful businesses—so it is difficult to generalize. Even so, in a majority of cases we can conclude that more education increases the chances of success. Entrepreneurs and small business owners are almost without exception on perpetual journeys of self-education. Systems scientist Peter Senge said, “people with a high level of personal mastery are acutely aware of their ignorance, their incompetence, their growth, and they are deeply self-confident.”¹⁷

The Small Business Administration (SBA) and other nonacademic agencies offer start-your-own-business seminars to prospective entrepreneurs. Executive education programs offered through college extension departments provide curricula specifically designed for entrepreneurs and small business owners. These 1-day to 1-year programs provide valuable skills without a degree.

Obtaining practical experience in your type of business is an important part of your education. You can learn valuable skills from various jobs that will prepare you for owning your own business. For example, working in a restaurant, in retail sales, or in a customer service department can hone your customer relations skills, which are crucial in running your own business but difficult to learn in a classroom.

The analytical and relational skills that you learn in formal educational settings are important, but remember that your future development depends on lifelong learning. (*Commencement*, after all, means “beginning”—the beginning of your business career!) Finally, don't overlook hobbies and other interests in preparing for self-employment. Participating in team sports and student organizations, for instance, can cultivate your team spirit and facility in working with others. Your marketing skills can be improved through knowledge of languages or fine art. Sometimes an avocation can turn into a vocation. For example, more than one weekend gardener has become a successful greenhouse owner.

Of course, no amount of experience or education can completely prepare you for owning your own business. Because every person, situation, and business is different, you are certainly going to encounter situations for which you could not have possibly prepared. Get as much experience and education as you can, but at some point you must “take off and hang on.” You have to find a way to make your business go.

Data Analytics for Small Business Decisions

Small business owners need data they can rely on to make decisions about running their business. Until fairly recently, small business had difficulty accessing what is known as big data—data from large databases. Now, not only can they access it, they can use big data to create a sustainable competitive advantage. Six reasons why data can give your small business a competitive advantage are

- **Data is a source for insights.** Business decisions that are not based on data analysis are called *opinions*. Data analysis and data visualization make decision making possible in the quest for hidden opportunities.
- **You can leverage offline data.** While databases are full of search queries, clicks, and purchases all providing insights into what buyers do online, there is a wealth of data available from surveillance of in-store shoppers. Such as, what types of packaging, colors, displays, and locations influence consumer preferences and behaviors?
- **Data provides a competitive advantage.** Data tools take the guesswork out of zooming into the local market by providing a solid idea of how customers think—personal touches provide competitive advantage.
- **Data helps you manage your online reputation.** If consumers are only making a few posts to your company's social media, you can handle making direct comment responses.

But, if there are thousands of comments and reviews, what do you do? NLP (natural language processing) techniques break down larger dynamics so you can create a Facebook application to retrieve and analyze public posts.

- **Data is fuel for AI research.** The search to perfect artificial intelligence is the current business Holy Grail being sought for business analytics. Your small business can access public and commercial databases, crowdsourcing data, and information from other data-driven businesses to automate your analysis of posts, comments, and searches.
- **Data is an instrument of personalization.** Since a fundamental advantage of small businesses is the closeness to their customers, data can now bring that advantage to the online world. Insights from data can allow you to deliver content that your customers find relevant based on their searches and products they have viewed. Personalization is a powerful tool in retaining customers.

By definition, big data is, well . . . huge. Small business owners need tools to gather, access, analyze, and display it. Some of the best tools startups include

- Google Analytics: Track website traffic, average stay time, bounce rate, and much more.
- Hotjar: Generate heatmaps to see how users interact with pages on your website.
- Hubspot: Evaluate marketing efforts using open and response rates among others.
- Salesforce: Recover lost leads and potential customers who abandon a purchase.¹⁸

OK, you found data to analyze for your startup, what do you look for? Key data points exist (and vary) for every type of business but solid starting points for any small business include

- **Customer Acquisition Cost (CAC):** the amount you spend to gain one new customer for your business. Get that by totaling ALL your sales and marketing costs (including overhead expenses, like employees) for a specific time period, like 1 month. Then divide by the number of customers you gained in that same period. If you spent \$10k in one month and gained 1,000 new customers, your CAC is \$10.
- **Life Time Value (LTV):** The total revenue that a customer will deliver to your business over time.
- **Churn:** The percentage of customers who do not return during a given period. How much churn is too much? A common “rule of thumb” in data analysis holds 5 percent a year or less to be ideal (SOME customers will always go) and higher than 10 percent is cause to improve the customer experience.
- **Burn:** The rate at which your business is spending the money that is available.

CREATING COMPETITIVE ADVANTAGE

Are You Ready?

Becoming an entrepreneur is not for everyone. In business, there are no guarantees. There is simply no way to eliminate all of the risks. It takes a special person with a strong commitment and specific skills to be successful as an entrepreneur.

Are you ready to start your own business? Use the following assessment questions to better understand how prepared you are. It is *not* a scientific assessment tool. Rather, it is a tool that will

prompt you with questions and assist you in evaluating your skills, characteristics, and experience as they relate to your readiness for starting a business. Here are a few questions from the SBA Learning Center to test for your readiness to start a business.

General

- Do you think you are ready to start a business?
- Do you have support for your business from family and friends?
- Have you ever worked in a business similar to what you are starting?
- Would people who know you say you are entrepreneurial?
- Have you ever taken a small business course or seminar?

Personal Characteristics

- Are you a leader?
- Do you like to make your own decisions?
- Do others turn to you for help in making decisions?
- Do you enjoy competition?
- Do you have willpower and self-discipline?
- Do you plan ahead?
- Do you like people?
- Do you get along well with others?
- Would people who know you say you are outgoing?

Personal Conditions

- Are you aware that running your own business may require working more than 12 hours a day, 6 days a week, and maybe Sundays and holidays?
- Do you have the physical stamina to handle a “self-employed” workload and schedule?
- Do you have the emotional strength to deal effectively with pressure?
- Are you prepared, if needed, to temporarily lower your standard of living until your business is firmly established?
- Are you prepared to lose a portion of your savings?

Skills and Experience

- Do you know what basic skills you will need in order to have a successful business?
- Do you possess those skills?
- Do you feel comfortable using a computer?
- Have you ever worked in a managerial or supervisory capacity?
- Do you think you can be comfortable hiring, disciplining, and delegating tasks to employees?
- If you discover you do not have the basic skills needed for your business, will you be willing to delay your plans until you have acquired the necessary skills?

Source: Learning Center (website) U.S. Small Business Administration, n.d., www.sba.gov/services/training/onlinecourses

Concept Check Questions

1. If a friend told you that entrepreneurs are high-risk takers, how would you set the story straight?
2. Explain why people who own a small business may not enjoy pure independence.
3. If personal characteristics or personality traits do not predict who will be a successful entrepreneur, why are they significant to the study of entrepreneurship or small business management? Which characteristics do you think are most important?
4. Think of an activity that you love to do; it could be a personal interest or a hobby. How could you turn your passion for this activity into a business? What questions would you have to answer for yourself before you took this step? What triggering events in your personal life would it take for you to start this business?

CONCEPT MODULE 2.4: CREATIVITY AND INNOVATION IN SMALL BUSINESS

Innovation—those new, more efficient and effective products, processes, services, technologies, or models—is the catalyst for business growth. Small businesses make major contributions of innovation in the U.S. economy, largely due to the economic incentive that comes with successful commercialization.

Experts often use patenting activity to measure innovation. Small innovative firms with only one to four employees apply for about 270 patents per 1,000 employees—nearly 25 times as many as any other size category and over 50 times as many as large business size category. Small businesses generate a full third of all patents in both smart grids and solar energy, and 15 percent of patents in batteries and fuel cells. Small businesses make nearly \$2.5 billion in patent licensing revenue each year.¹⁹ The bottom line—small businesses are a big deal when it comes to innovation.

In a report titled *Small Innovative Company Growth—Barriers, Best Practices and Big Ideas*, Mark Harrison identified a six-stage model innovative company development process (Figure 2.6):

- **Discovery/Identified Market Need:** A small business owner generates an idea for an innovation based upon research, building on previous development, opportunity recognition of a market need, or customer feedback.
- **Technology Demonstration:** The small business owner shows due diligence in analyzing the idea to make sure it is viable. This can take the form of experiments, building prototypes, or market assessment.
- **Product Development:** The small business owner extends the testing from the previous stage (assuming positive results) in refining product design, pilot testing, and identifying production options and possible distribution channels.
- **Commercialization/Market Entry:** Once the small business owner has a viable product, it is time to begin the generation of revenue with heavy emphasis on marketing and selling. Refinements to the manufacturing processes are normal.
- **Early Stage Growth:** Successful product launch leads to small business growth and investment in materials, human resources, and infrastructure.
- **Economic Development Impact Growth:** In this stage, the small business generates significant revenue, increases hiring, likely makes capital investments in land and buildings, and pays higher taxes that support and enhance local economies.²⁰

FIGURE 2.6 ■ The Six Stages of the Innovation Process



The same report identified barriers and challenges specific to small businesses that are attempting to commercialize innovative products or technology:

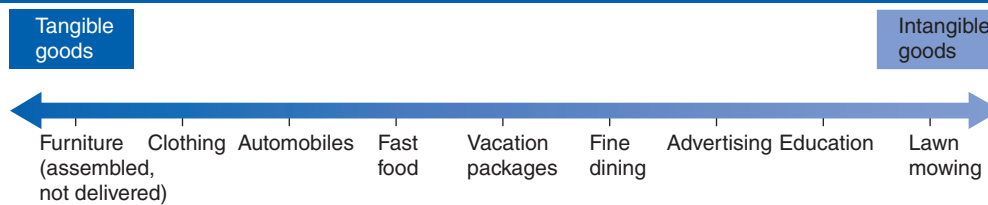
- The amount of student debt held by graduating students prevents them from pursuing entrepreneurial opportunities.
- The amount of funding and support of research and development in the United States needs to increase to ensure continued innovation.
- Entrepreneurs often lack information regarding market needs and product research and development efforts.
- There is a shortage of engineering and production job talent.
- Access to capital still remains a large barrier for small business growth.
- Small innovative companies have difficulty in commercializing products.
- Technology diffusion and adoption is harder for small businesses.
- The high costs of acquiring equipment and implementing a new technology [are] a barrier to entry for small businesses.
- Small companies need access to more business opportunities.
- Innovations often result in legal and/or regulatory challenges or uncertainty.
- Small companies continue to face challenges to exporting their products and services.²¹

Product Innovation

Innovation can be seen in every facet of business, but for this small business discussion we are primarily limiting the scope to products. Remember that **product** means tangible goods, intangible services, or a combination of these (Figure 2.7). Hiring someone to mow your lawn is an example of the service end of the goods-and-services spectrum. In this case, you don't receive a tangible good.

An example of a tangible good would be the purchase of a chair that is finished and assembled, but not delivered. Thus, in this case, you don't receive any services. Many businesses offer a combination of goods and services. Restaurants, for instance, provide both goods (food and drink) and services (preparation and delivery).

FIGURE 2.7 ■ Spectrum of Goods and Services



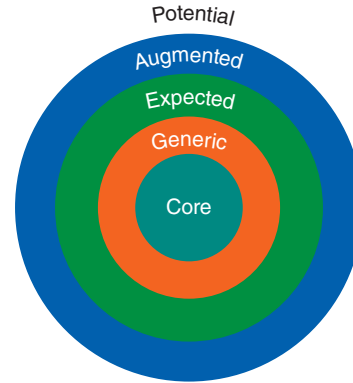
While small businesses develop and commercialize much innovation, another source of initial innovations is primary research—which small businesses may still develop without their own research and development. Some sources of innovations include

- **Global Innovation Initiative**—This program provides grants to university consortia focusing on science, technology, engineering, and mathematics, or STEM-related issues of global significance that foster cutting-edge multinational research and strengthen institutional international partnerships.
- **America Makes**—America Makes supports and facilitates research collaboration among leaders from business, academia, non-profit organizations, and government. Its research efforts are aimed at enabling technology transition from universities and government (i.e., basic research) through to commercialization.²²
- **National Network for Manufacturing Innovation**—NNMI is a network of research institutes that focuses on developing and commercializing manufacturing technologies through public-private partnerships between U.S. industry, universities, and federal government agencies. The network currently consists of nine institutes:
 1. National Additive Manufacturing Innovation Institute
 2. Digital Manufacturing and Design Innovation Institute
 3. Lightweight Materials Manufacturing Innovation Institute
 4. Next Generation Power Electronics Institute
 5. Institute for Advanced Composites Manufacturing Innovation
 6. American Institute for Manufacturing Integrated Photonics
 7. Flexible Hybrid Electronics Manufacturing Innovation Institute
 8. Advanced Functional Fabrics of America
 9. Smart Manufacturing Innovation Institute²³

Product Satisfaction

When thinking about product innovation, it is useful to think about different levels of product satisfaction. Products are the “bundle of satisfaction” that consumers receive in exchange for their money. The most basic level of product satisfaction is its *core benefit*, or the fundamental reason why people buy products (Figure 2.8). For an automobile, the core benefit is transportation from point A to point B. With a hotel room, the core benefit is a night's sleep. To put this another way, people don't buy drills—they really buy holes.

FIGURE 2.8 ■ Levels of Benefits Consumers Receive From Products



The next level of product satisfaction is the *generic product*. For an automobile, the generic product is the steel, plastic, and glass. For the hotel, the building, the front desk, and the rooms represent the generic product.

The third level of product satisfaction is the *expected product*, which includes the set of attributes and conditions that consumers assume will be present. U.S. consumers expect comfortable seats, responsive handling, and easy starting from their cars. A hotel guest expects clean sheets, soap, towels, relative quiet, and indoor plumbing.

The *augmented product*, the fourth level of product satisfaction, is all the additional services and benefits that can distinguish your business. For example, night vision built into windshields, satellite-linked navigational systems in autos, and express checkout and health club facilities in hotels are product augmentations. Augmentations represent the sizzle that you sell along with the steak. The problem with product augmentations is that they soon become expected. When you have raised your costs and prices by adding augmentations, you open the door for competitors to come in and offer more of a generic product at a lower price. That's how the Motel 6 franchises became so successful—by offering a plain room for a low price when competitors were adding amenities that raised their cost structure and prices.

The fifth and final level is the *potential product*. It includes product evolutions to come. Not long ago, taking video with a cell phone or still camera was not possible. It soon became a product augmentation and, very quickly, expected.

Thus the products that you develop and sell in your small business are more than just a combination of tangible features. Always keep in mind which core benefits customers receive from your product, how the actual product satisfies those core needs, and how you can augment your products to make them more appealing.

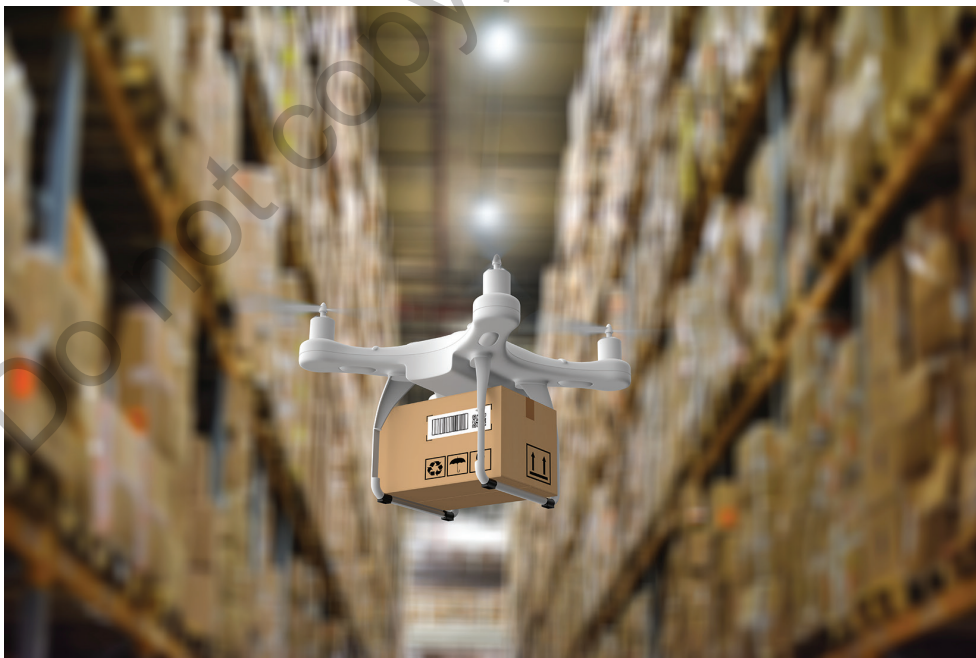
Developing New Products

Trends like increased global competition and quickly changing customer needs have shortened product life cycles and increased the need for new products.²⁴ As a company's current products enter the stages of late maturity and decline, they need to be replaced with new ones in demand. What is new? Good question. Marketing consultant Booz Allen Hamilton groups new products into six categories:

1. *New-to-the-world products*. These are products that have not been seen before, which result in entirely new markets. Ken Fischer developed and patented a marine paint the U.S. Navy uses to keep its ships free of barnacles. The paint is made from a mixture of epoxy and cayenne pepper. Fischer came up with the idea for the paint after blistering his mouth on a Tabasco-covered deviled egg. He decided that animals would react the same way. He was right.²⁵
2. *New product lines*. These are products that exist but are new to your type of business. For example, the addition of a coffee bar to your bookstore would be taking on a new product line.

3. *Extensions to existing product lines.* These are products that are extensions of what you already sell. For example, a small business that adds a new line of innovative tablet cases to its existing cell phone cases would represent a product-line extension.
4. *Improvements in, revisions of, or new uses for existing products.* These are products that have had their value increased. Take the example of WD-40 spray lubricant. Although it was originally developed to prevent rust by displacing water, so many new uses have been found for it that the WD-40 Company holds an annual “Invent Your Own Use” contest. Besides quieting squeaky hinges and freeing zippers, the product also removes gum stuck in hair or carpet, and sticky labels from glass, plastic, and metal. The Denver Fire Department even used WD-40 to free a nude burglary suspect who got stuck while attempting to enter a restaurant through an exhaust vent.
5. *Repositioning of existing products.* Entrepreneurial jargon typically calls this procedure “pivoting” but the process is the same. Many products and businesses are created with one purpose in mind but end up finding success in another arena—including Post-it Notes (originally created to mark pages in the inventor’s church choir songbook) and Viagra (originally formulated to treat angina—chest pain associated with poor circulation to the heart).
6. *Lower-cost versions of existing products.* These are products that provide value and performance similar to those of existing products but at a lower cost. For example, food stands that sell hamburgers and hot dogs offer products similar to the big-name fast-food franchises but at a lower price, thereby enticing customers with their cost advantage.

Of course, increased risk is associated with the launch of new products. How many new products can you remember seeing on the shelves at the grocery store in the last year? Ten? Fifty? One hundred? Now think of how many of those you chose to buy or adopt. However many you remember, it was surely far less than the 10,000 new food products and 5,000 nonfood items introduced in grocery stores each year.²⁶ Many of those new products did not survive. Nevertheless, despite the risk, innovation is the key to success. Innovation is part of being proactive in the marketplace.



baranozdemir / iStockPhoto

Inventor's Paradox

Consider the following scenario. You have developed a new product that fits into one of the six categories cited above. What are your options? The best alternative is to start and run your own business based on the new product—that option is the foundation of this whole book. But what other options exist?

Unfortunately, many product innovators believe they simply need to generate an idea for a new product, service, or process, and Uber-Corporation X will pay them massive amounts of money for this idea. Sorry to disappoint you, but ideas are worth very little in the business world. In fact, most companies strongly discourage inventors from approaching them with ideas. Why? Because they have been approached by hundreds of people who want to cash in on undeveloped ideas. Of course, some people have convinced members of a large corporation that they are serious inventors who have marketable ideas, but lightning has struck in the same place twice, too. Just don't count on it happening.

If you do gain an audience with a corporate representative to whom you can make a proposal and a presentation, you have a better chance of walking out with a **licensing agreement** than a check. Under a licensing agreement, the owner of intellectual property grants another person (or another company) permission to produce that product. In exchange, the inventor receives royalties, which constitute a percentage (generally 5 percent to 6 percent) of sales. The inventor relinquishes control over what the licensee does with the product. Your chances of getting a licensing agreement are greatly improved if you are already producing the product and have established a track record of sales. Your chances of getting a licensing agreement dwindle if you are seeking a license because you don't have enough money to develop the product yourself.

Another alternative for an inventor may be **private-label manufacturing**. For example, Sears does not own a factory in which it builds its Craftsman tools. Instead, the company engages other companies to make the tools to its specifications and puts the Craftsman brand on them. This is where you, the tool inventor, could enter the picture.

If you have designed a new tool that Sears does not currently have in its product line, you might be able to secure an agreement to produce that tool under the company's brand name. You will get only about one-half of the retail price, but at least you have a sales base from which to begin your operations. A serious downside to this strategy is that you have just one major customer, so your company's fortunes will hang on that firm's willingness to maintain the agreement.

Recall the Chapter 1 discussion of the symbiotic relationship between large and small businesses. Here is another possible connection where each party needs the other: Similar to private-label manufacturing, you could become an *OEM* (*original-equipment manufacturer*), a company that makes component parts or accessories for larger items.²⁷ For example, your firm might produce circuit boards for computer manufacturers or custom knobs for cabinetmakers.

Importance of Product Competitive Advantage

Few would argue that the length of time many products have before they become obsolete has decreased rapidly over the past few years. Factors such as new technologies, increasing numbers of substitute products, quickly changing consumer tastes and preferences, and shifting consumption patterns all play large roles in this rapid phase-out of existing products. Small businesses are more vulnerable to product obsolescence because they typically depend on fewer key products and have fewer resources with which to develop new ones. In addition, the niche markets that small businesses serve can dry up or be lured away by a larger, low-cost competitor. The optimal scenario for these businesses features a steady stream of new products being developed to replace existing ones as they pass through the product life cycle.

Unfortunately, no one actually runs a business that operates within the optimal scenario. Instead, the best you can do is learn from other successful small businesses. A recent study illustrated some fundamental practices of small businesses that succeed in creating and retaining a competitive advantage. Notably, they maintain their focus on specialized products serving niche markets and rely on their

existing core competitive advantage to enter new markets. A *sustainable competitive advantage* is based on something that firm does better than others—a *core competency*. To be classified as a core competency, a factor should satisfy three criteria:

1. Be applicable across a range of products.
2. Be difficult for competitors to duplicate.
3. Provide a fundamental and valuable benefit to customers.

Assuming their core competencies are intact, successful companies share some common characteristics that can be termed *best practices*. They

- *Leverage existing capabilities*—meaning they understand what they do well, and they use those skills to enter new markets.
- *Set team expectations*—getting your entire team together regularly (for example, twice a month) to discuss each department’s accomplishments and challenges.
- *Enter growth markets*—and thereby avoid cutthroat price competition and zero-sum games.
- *Manage without ego*—small businesses run on margins that are too thin for owners to believe that their ideas and processes are the best and only ways. Get feedback from your team.
- *Target niche markets*—by definition, niche markets are less crowded with competitors than mass markets, and customers in niche markets are willing to pay premiums for specialized products.
- *Diversify*—so as to spread risk, or, as the cliché goes, they don’t put all their eggs in one basket.
- *Add new capabilities*—by building a set of skills, such as technology, marketing, or distribution.
- *Have clear and documented processes*—documentation leaves little room for miscommunications.
- *Keep the 3 Ps in mind*—Marcus Lemonis builds solid operations with them in his show *The Profit*. So should you—process, people, and product.
- *Have low overhead*—because they have a lean management structure, and they avoid major new investments in buildings and equipment by adding extra shifts and overtime.²⁸

Concept Check Questions

1. What factors might affect how long a product remains in each stage of the product life cycle? What can a small business owner do to extend each stage?
2. Many small businesses are built around one product. What risks does this approach impose? How can small business owners minimize those risks? How can a small business develop new products?

CHAPTER REVIEW

Summary

LO 2.1 Articulate the differences between the small business manager and the entrepreneur.

An entrepreneur is a person who takes advantage of an opportunity and assumes the risk involved in creating a business for the purpose of making a profit. A small business manager is involved in the day-to-day operation of an established business.

Each faces significant challenges, but they are at different stages of development in the entrepreneurship/small business management model.

LO 2.2 Discuss the steps in preparing for small business ownership.

The entrepreneurship process involves an *innovative* idea for a new product, process, or service. A *triggering event* is something that happens to the entrepreneur that causes him to begin bringing the idea to reality. *Implementation* is the stage at which the entrepreneur forms a business based on her idea. The first stage of the small business management process is *growth*, which usually means the business is becoming large enough to generate enough profit to support itself and its owner. The *maturity* stage is reached when the business is stable and well established. The *harvest* stage occurs when the small business manager leaves the business because of its sale, merger, or failure.

LO 2.3 Enumerate the advantages and disadvantages of self-employment.

The advantages of self-employment include the opportunity for independence, the chance for a better lifestyle, and the potential for significant profit. The disadvantages include the personal liability you would face should the business fail, the uncertainty of an income, and the long working hours.

LO 2.4 Explain the role of innovation to small business.

Product innovation is the catalyst for all business growth and small businesses make major contributions of innovation in the U.S. economy because they have more economic incentive to create truly innovative products than do large businesses. Innovation includes those new, more efficient and effective products, processes, services, technologies, or models.

KEY TERMS

entrepreneurship	maturity
entrepreneurship process	need to achieve
environmental factors	private-label manufacturing
growth	product
harvest	small business management
implementation	small business management process
licensing agreement	triggering event
locus of control	

EXPERIENTIAL LEARNING ACTIVITY

2.1: Stages of Preparing for Small Business Ownership

LO 2.2: Discuss the steps in preparing for small business ownership.

Using the information found in Chapter 2, which step in preparing for small business ownership is represented by each of the following scenarios?

1. Sally has a great idea for improving the efficiency of moving her product from Point A to Point B.
2. Kathy's business has now reached a critical mass, providing a living for herself and her family.
3. Robert's company has been in the community for over 20 years and is well established with several of his children now working in the family business.
4. Greg was just laid off from his company and now has time to pursue his business idea he has been thinking about for years.
5. John has spent the last two years developing, testing, and determining a production process for his amazing new carpentry tool. He is now ready to begin the production process, open the doors of his store, and sell his product.

6. After years of successfully owning her flower shop, Jenna has sold her business to a newly graduated college student. Jenna plans to pursue her painting passion.
7. Jamie has had a great idea for a new phone app for the last two years. She has shared her idea with her family and friends and everyone agrees it will be an awesome app.
8. Katie's restaurant has operated successfully for the last 15 years and is a community favorite. Her weekend crowd has many regular customers who enjoy Katie's well-known fish and chips.
9. After several years of hard work and dedication, Joe's automotive service has reached the point where Joe can quit his part-time job and devote all of his time to his automotive business. Joe now has a sufficient group of regular customers and can support himself and his family solely from the automotive business.
10. Kurt's boss has just offered him a promotion to regional manager, which should be a wonderful offer. However, if Kurt takes the promotion, he will no longer have time to implement his coaching clinics, which he has been planning for the last several months.

2.2: Innovation

LO 2.4: Explain the role of innovation to small business.

Invention is the creation of a new product or service. Innovation is making a current product or service better to fulfill a consumer need or want.

1. For the products listed to the right, list whether each product is an invention or an innovation.
2. After you have categorized each product, break into groups and brainstorm ideas for three products to develop further innovations. Explain the six stages of innovation used to make your product a success.

_____ A telephone in 1875

_____ A pizza place that now sells chocolate chip dessert pizzas

_____ The cell phone in 1973

_____ A machine linked to a computer that expertly cuts material into any design chosen

_____ An electronic textbook

_____ A metal key to your hotel room

_____ A curling iron

_____ Frisbee golf

_____ Christmas lights for outside your house

_____ Fitbit to track your steps taken

CHAPTER CLOSING CASE

Solo Entrepreneurship in the Video Game Industry: What Is the Best Growth Strategy for Stardew Valley After Early Success?

- **By:** Douglas R. Ewing
- **Publisher:** SAGE Publications: SAGE Business Cases Originals
- **Publication year:** 2022

Abstract

The farming video game *Stardew Valley* was launched to critical and commercial success in 2016. Lone developer Eric Barone wants to stay competitive in the popular and ever-changing gaming industry, but to do so he must ensure his product stays fresh and he connects with users. How should he

proceed? So far Barone has considered several options. One is to seek development assistance. He could hire other creators to add on to or improve *Stardew Valley*. Doing this would help to ensure the original game does not go stale while freeing him to pursue other video game projects or expand into related categories. However, hiring is expensive. To simply stay in the game—whether his business sees actual growth—Barone must constantly refresh his product, his methods of extracting revenue, his practices of interacting with the various players in the video game ecosystem, or a combination of these. This case challenges students to assess a situation where past success had been unlikely and to make forward-looking recommendations that account for a crowded competitive space beholden to user generated content and concentrated methods of product distribution.

Case

LEARNING OUTCOMES

- Build an argument for how a solo entrepreneur can capitalize upon early success in a crowded marketplace.
- Describe barriers between the creative process and product development, and various options for clearing such barriers.
- Analyze how different players in an industry ecosystem function together.

Introduction

Eric Barone believed he could make a video game that would appeal to a niche audience. The first decade of the 2000s had drawn to a close, and the video game industry was growing (Mintel, 2019). The industry had become sufficiently mature to evidence established, often formalized, buyer–seller relationships that formed a discernible value chain (see Figure 2.9). A coincident trend of small, sometimes individual, developers creating new titles and providing technical support for existing ones had appeared by 2011. The conventional industry value chain had been thoroughly disrupted with alternative paths to development and distribution available to even the smallest developer. Video game distribution had become largely electronic without need for the volumes and relationships that physical retail requires.

Electronic distribution platforms like Steam had become established in selling video game downloads and providing tools to facilitate engagement between developers and users. These platforms facilitated product listing, prerelease interaction with a community of prospective users, and eventual release and ongoing support. With these tools, “indie” developers had occasionally published titles that rivaled and outclassed those of firms with comparatively limitless resources and established reputations (Schreier, 2017). An explanation for these successes may have already had analogues in other categories (Porter & Heppelmann, 2014). Changes in the structural forces driving the video game industry had empowered a new class of competitor: the small developer.

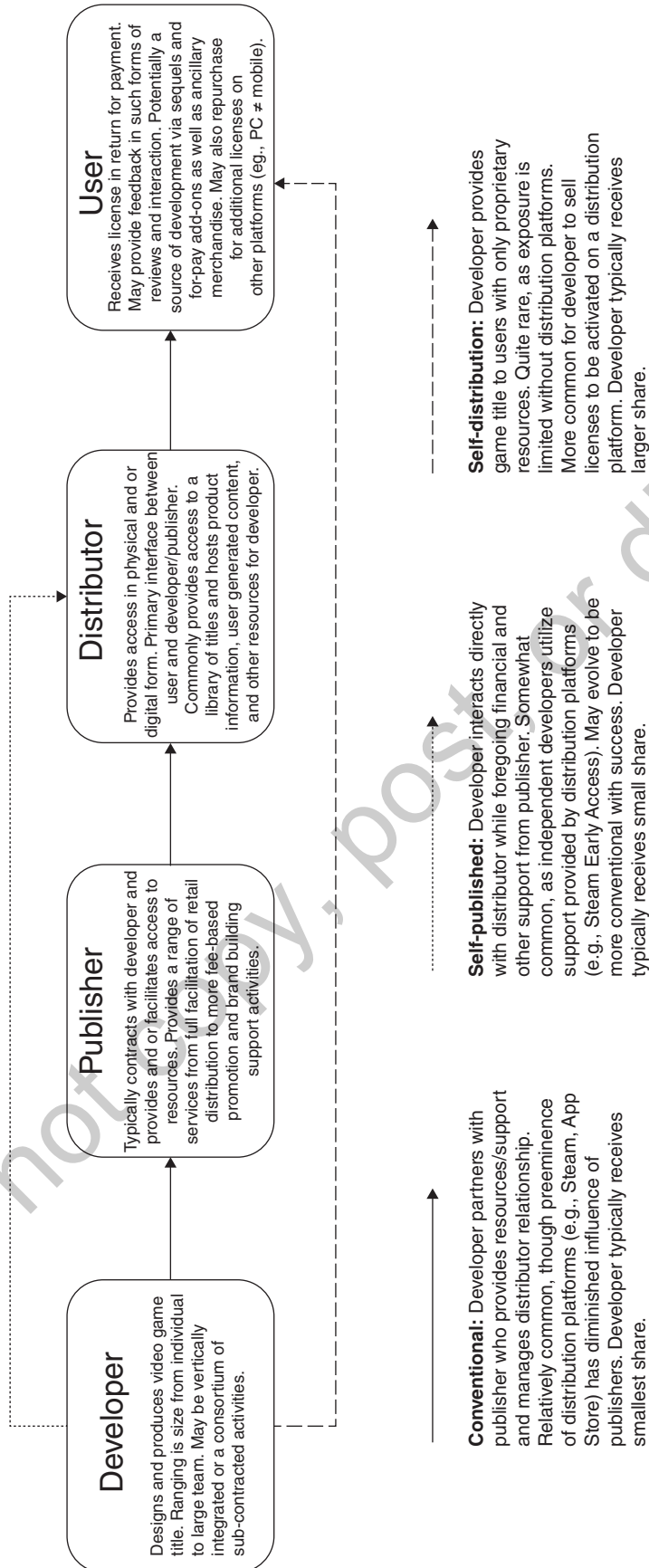
Planning a New, Retro Farming Game

Barone had been inspired by the video games of his youth such as *Harvest Moon* (Singal, 2016). Titles in this series consisted of farming combined with fantasy role-playing elements. Farming was perhaps not an initially “obvious” topic around which to build a video game. However, the cult-like following around *Harvest Moon* suggested there would be at least a small, interested segment. The success of other farming titles such as the *Farming Simulator* series supported this conclusion (Gera, 2014). The success of *Minecraft* further suggested that less structured, “sandbox” titles can have a dedicated and enduring following (Etherington, 2014).

Farming is an ongoing endeavor both in real life and in a game. Tilling, planting, watering, weeding, harvesting, and selling are all relevant as well as purchasing of inputs and fixtures to facilitate these activities. A farming game in its purest form would be a labor-focused business simulation. Gamifying farming would need to see the addition of storylines, goals, and additional context to direct, assist, and engage a player.

Stardew Valley was planned to have many activities for a player and not necessarily require that all (or any) of them be completed (Barone, 2015a). A player could choose to focus on the main plot of *Stardew Valley*: the restoration of a family farm. Running and expanding this farm would see the

FIGURE 2.9 Value Chain of Video Game Development



player raising crops and livestock as well as building fixtures such as barns and irrigation systems. Success in these activities would depend on acquiring necessary resources such as building materials and plant seeds through gathering and trade. In addition, success would depend on five “skills” of the player’s character: farming, mining, foraging, fishing, and combat. These attributes could increase over time as the player decided how to allocate “experience points” across all five skills.

Experience points would accrue to the player as they made progress in restoring and running the farm. In addition, a player could engage in a variety of other activities including but not limited to completion of tasks for townspeople, competing in contests associated with seasonal festivals (the game world had time and seasons), seeking a romantic partner, fishing for various sea life, gathering food and items, and delving into caves. Completing these would also provide experience points and, in some cases, unlock additional functionality and features. Essentially, *Stardew Valley* had a gameplay loop of run the farm and be part of a community—earn experience—build skillset—have a subsequently more intricate experience. The game was designed with this gameplay loop in mind such that successful completions of this cycle advanced progress toward a series of successive, story-implicating goals. Notably, *Stardew Valley* could also be played as a “sandbox,” with the player giving little attention to a conventional plot and instead inhabiting the pixelated world of *Stardew Valley* as they saw fit.

From Concept to Software

As described by the *Stardew Valley* press page (<https://www.stardewvalley.net/press/>), the gameplay features, functional underpinnings, creative elements, and marketing decisions were formed into the game by one person: Eric Barone aka “ConcernedApe.” Solo development meant not only gameplay design and programming but also creative control over all aspects of the game including art, music, story writing, distribution, tech support, publicity, and marketing. Even large software development teams experience intense pressures to complete video game titles (Kerr, 2016). Solo development would place all the stress upon one person. Consequently, timelines for *Stardew Valley* were regularly revised and extended as Barone labored over many months. He also suffered tremendous social and financial costs as the lone developer. Personal relationships were difficult to maintain while he focused all efforts on *Stardew Valley*. Financial obligations piled up, as the title was his primary activity but not yet available for sale (Schreier, 2017). He documented much of the development process in a blog on his website, signing posts under his “ConcernedApe” creative alias (<https://www.stardewvalley.net/blog/>). A general timeline of development and release for *Stardew Valley* unfolded as follows:

- 2011: Barone envisioned a console game and began development for the Microsoft Xbox.
- 2012: Failing to make initial progress with Xbox development, he turned his sights to the personal computer (PC). He retained the services of a publisher, Chucklefish, who would assist with distribution, web presence, and other back-office aspects of the title (Barone, 2013). Chucklefish would take 10% of any future profits in exchange for continuing to promote *Stardew Valley* (Schreier, 2017). Barone opted to take advantage of a program called Greenlight on the Steam distribution platform. The rate of game releases on the Steam platform was increasing with 1,771 in 2014, 2,964 in 2015, and 4,207 in 2016 according to a report on the video game industry by Statista. Steam had emerged as the leading digital outlet for both professional and independent PC video games (Clement, 2021). The Greenlight program allowed potential users to follow the development of titles such as *Stardew Valley* before release. These prospective users were empowered to engage with developers and vote for titles that they wanted to have available to buy on the Steam platform (Barone, 2013).
- 2013–2015: The creation of *Stardew Valley* typified software development and was neither smooth nor timely. Barone risked disappointing interested users as release dates were pushed back. His choice to design the gameplay, build the underlying game engine, and craft all artistic elements by himself, including graphics and music, led to a protracted timeline. New problems emerged, major changes in design occurred, and deadlines were missed (Frank, 2016). One major change was the prospect of *Stardew Valley* launching without simultaneous multi-player functionality. This was an expected feature that Barone found difficult to implement (Schreier,

2017). Relatively few additional details of ongoing delays at this time were made public. However, a blog post by Barone suggested he was struggling to remove software “bugs” while also trying to have a game that was complete at launch. As he said, “It simply could not be released in its current form . . . It’s not a finished game yet. It’s tantalizingly close to being a finished game, but it’s also a huge project and I’m just one guy” (Barone, 2015b). The grueling nature of game development also had begun to take its toll, with Barone experiencing loneliness and self-doubt as well as his personal relationships being put under stress from his singular focus on *Stardew Valley*. Nonetheless, the publisher, Chucklefish, streamed live video of *Stardew Valley* pre-launch gameplay in late 2015 and received positive feedback from prospective players (Schreier, 2017).

- 2016: *Stardew Valley* formally launched on February 26, 2016 (Barone, 2016). According to SteamSpy (<https://steamspy.com/app/413150>), over 150,000 licenses were sold on launch day, and more than 150,000 additional licenses were sold in the first week. Brisk sales suggest there had been a critical mass of interested and supportive users. Barone’s relationship with users in the Steam community via developer blog posts and comments and forum interactions to date had been positive, realistic, and rather collaborative. It likely helped to buy him the time to keep developing the title (Schreier, 2017).

Initial Launch and Marketing

Stardew Valley was developed and launched with little formal marketing strategy. Barone openly admitted that marketing was not his area of expertise. His publisher, Chucklefish, had been retained to fill this gap in his skillset. The development of *Stardew Valley* was more akin to a work of art created by a single artist than a product designed through a formal process. For most of the development timeline, Barone had been engaged with prospective users but shared little concrete information about *Stardew Valley* beyond screenshots and descriptions. His interactions with them were candid rather than presentations of features meant to generate buzz. He had openly shared successes and failures on his blog and on the Steam platform. This transparency was assumed to have created an interested and engaged audience, though he admitted that he had no idea of possible sales volume even on launch day. There had been no market research that may have led to understanding target segment preferences or even a clearer understanding of overall demand for the game (Schreier, 2017).

The appearance of *Stardew Valley* for sale on the Steam platform was relatively straightforward and reflected the informal and unconventional nature of its development process. The expected gameplay and relevant elements in the title for sale were mostly present, though some planned features such as multiplayer support were not yet available. The title was presented on its Steam store page as an independent retro-inspired farming video game. It described the underlying story of the game and features including gameplay elements and aspects of the small-town coastal setting. User reviewers, expected to be posted in the future once written by players, would be hosted on the Steam store page of *Stardew Valley*.

The launch price was featured prominently on the Steam page and was USD 14.99, a level that was much lower than mainstream titles. No promotional pricing was offered. Barone eschewed some trends in the video game industry by having no “free-ium” version of the title available, no “pay-to-win” pricing tiers, no subscription model for maintaining access to the game, and no plan to charge for new functionality or features in the future. Buying a license to *Stardew Valley* would be a one-time payment on Steam, and the platform would take a 30% commission on each sale (Marks, 2020). Chucklefish would be paid 10% of the remainder.

Chucklefish had distributed advance copies to media outlets and video game streamers to foster early reviews of the title in late 2015 into early 2016 (Singal, 2016). On Twitch, a video game streaming website, advance copies to streamers in January 2016 made *Stardew Valley* one of the most popular game titles to watch being played in the month prior to launch (Schreier, 2017). Streaming of *Stardew Valley* gameplay during this pre-launch month was the first opportunity that many prospective buyers had to see the game in action before purchase.

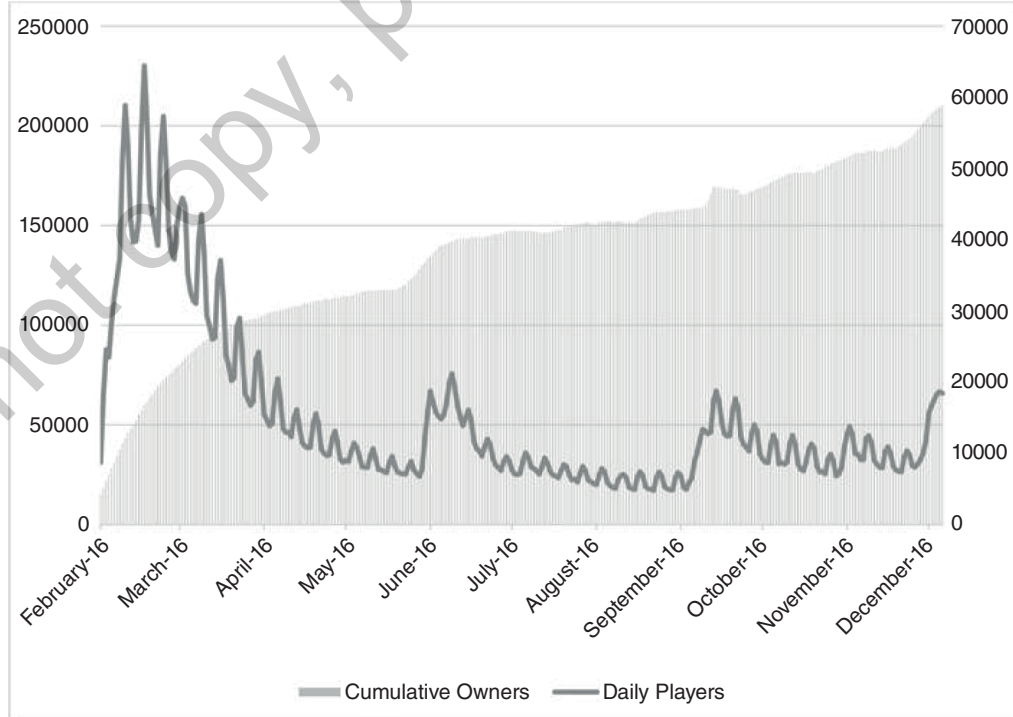
Even with this limited set of tactics, the launch of *Stardew Valley* was an unmitigated success. Early reviews from users, video game personalities, and journalists were positive (see Table 2.1). Barone received a warm reception when he attended a trade show, Penny Arcade Expo, shortly after launch (Barone, 2016). The title sold more than a one million copies by April 2016, two million copies by the end of 2016, and appeared to have a solid base of players according to SteamDB (<https://steamdb.info/app/413150/>) (see Figure 2.10). *Stardew Valley* was nominated to be the 2017 Game of the Year by the British Academy of Film and Television Arts (2017).

TABLE 2.1 ■ Quotes From Early Critical Reviews of *Stardew Valley*

<p>“It’s easy to get lost for hours. Sure, there’s a lot to do and a lot of ways to play, but each path also has purpose and detail. Completing even the smallest tasks gave me a sense of accomplishment and kept me digging to find more things to do.” (Velocci, 2016 for <i>Polygon</i>)</p>
<p>“My favorite thing about <i>Stardew Valley</i> is not just that there’s a lot to see and do, but that it’s (almost) all intertwined.” (Plagge, 2016 for <i>IGN</i>)</p>
<p>“<i>Stardew Valley</i> is an absolutely charming little gem about forgetting all your worries and relaxing on a farm.” (Bogos, 2016 for <i>The Escapist</i>)</p>
<p>“<i>Stardew Valley</i> is definitely rough around the edges, but that didn’t matter when I was fishing on a little pixelated pier or making friends with a homeless person in a tent. Its imperfections never damage that feeling of gentle escape to the countryside.” (Lucas, 2016 for <i>PCGamer</i>)</p>
<p>“<i>Stardew Valley</i> is a farming and life simulator. But this isn’t like the more modern wave of ‘simulators’ that have dominated the genre. This is old school, <i>Harvest Moon</i>-inspired simulation. It has clear roots in that franchise, but it separates itself with many other mechanics thrown on top of just farming.” (Hancock, 2016 for <i>Destructoid</i>)</p>

Note: The quotes in this table represent a relatively broad cross-section of critical reviews of *Stardew Valley* near the time of its release. On balance, journalistic reviews such as these were very positive.

FIGURE 2.10 ■ *Stardew Valley* Peak Daily Players and Cumulative Sales (2016)



The success of *Stardew Valley* was counterintuitive. Solo-developed games often stagnated without a large budget and team of specialists. *Stardew Valley* had low-fidelity graphics and existed in a niche genre. Larger developers held that ever-improving graphics and focusing on genres more popular than

farming was the pathway to success. Independent studies of preferences supported this conclusion. A survey by Statista indicated that “action” games were played by 41% of gamers while “role-playing” and “simulation” categories, perhaps the most appropriate labels for *Stardew Valley*, comprised only 25% and 23% respectively (Kunst, 2020). *Stardew Valley* had beaten the odds. That it was developed by a single individual made its success even more impressive and made for a compelling story to tell. Eric Barone went from being a broke developer to having more money than he had ever had in his life (Schreier, 2017).

Navigating the Complex Video Gaming Ecosystem

The larger context around the development and launch of *Stardew Valley* was notable. The linear nature of the value chain in Figure 2.9 belies the complexity of the video game industry. The industry was a complex, interrelated ecosystem of developers, publishers, creative specialists, users, paid influencers, and distribution platforms in 2016. These elements interacted and influenced the flow of resources such as sales revenue, publisher outlays, and user time allocation, as well as public sentiment and discourse. For instance, larger numbers of users tended to facilitate access to creative specialists, paid influencers, and publisher interest. More popular titles tended to become more popular, having more future users as well as more user generated content in the forms of reviews, discussions, and direct inquiries. Barone needed to consider how emergent and potentially difficult-to-predict industry dynamics such as these could shape the future direction and success of *Stardew Valley*.

User Engagement and Product Development

The power of user engagement to influence success and failure in video game development was already notable by the time of the *Stardew Valley* launch (Schreier, 2017). Developer engagement with users was known to begin before titles were released. It had become common for developers to share imagery and descriptions to build interest and hype. After release, highly successful (unsuccessful) titles were more likely to be approached (avoided) based on user reviews. Such user generated feedback could make a title trend within or across distribution platforms giving rise to growth or sales suppression. Highly reviewed games also were more likely to garner coverage in journalistic media. Along these lines, Barone and *Stardew Valley* were surrounded by nearly uniformly positive sentiment from users and journalists. However, this had occurred despite apparent apprehension at “creating buzz over screenshots and speculation” before launch. It appeared that Barone had built his “reputation by releasing a great game” as promised and had done so organically rather than via careful planning (Barone, 2015).

A Plan for the Next Phase of *Stardew Valley*'s Growth

Barone finally was less constrained by finances and uncertainty about having a player base. He expressed a desire to develop additional publishable titles but also felt pressure to improve the game (Schreier, 2017). This would require him to manage the ongoing development of *Stardew Valley* while simultaneously creating new titles within a crowded category. The viability of his solo-development process as well as the relationship with publisher Chucklefish would likely need to be revisited. Barone needed short- and long-term direction for *Stardew Valley* as he looked ahead from 2017 (Singal, 2016). Despite having taken an ad hoc approach to date, he stood to benefit from a growth plan that could be adapted as the months and years ahead unfolded (Ries, 2011). Several options were possibly available to him:

- focus only on *Stardew Valley*, adding features and improving it over time;
- maintain *Stardew Valley* and begin concurrent development of additional title(s);
- develop a sequel to or reinterpretation of *Stardew Valley*;
- adopt a new pricing model where additional content becomes available with payment;
- hire and/or contract staff for development assistance;

- seek licensing agreements inside (e.g., product placements) or outside (e.g., merchandising) of *Stardew Valley*:
 - *Stardew Valley* toys/collectibles for kids and/or adults.
 - *Stardew Valley* board game or card game leveraging theme.
 - External gardening, fishing, or other brands appearing in *Stardew Valley*.
 - Licensing *Stardew Valley* brand to gardening, fishing, or other manufacturers.
- seek to exit via an intellectual property sale or similar arrangement.

Barone knew that each of these options warranted consideration, if for no other reason than they already had existing precedents in the video game industry. How these options were prioritized or combined, possibly as part of a rollout plan for a new game, would influence the trendline of success for *Stardew Valley* as 2016 faded into 2017. Growth may come from user loyalty, network effects and “buzz,” or additional paid users (Ries, 2011). In any case, Barone knew that pivot would be necessary, even if small, to sustain the success of *Stardew Valley* and preferably, to build on the brand he had created.

Discussion Questions

1. How would you describe the broader strategic situation for Barone and *Stardew Valley* in 2017 with respect to Porter’s Five Forces?
2. What elements of the successful launch of *Stardew Valley* may be repeatable in 2017, should Barone choose to create a new game? Under what circumstances would they be repeatable?
3. How would you characterize Barone’s approach to managing *Stardew Valley*’s user community? What changes would you recommend he make in his user engagement strategy, and why?
4. How would you prioritize the business growth options available to Barone? Describe your rationale and generally consider in terms of “pivots” and “engines” to growth.

Further Reading

- *Stardew Valley* Official Website: <http://www.stardewvalley.net>
- *Stardew Valley* Press Page: <https://www.stardewvalley.net/press/>
- *Stardew Valley* Developer Blog: <https://www.stardewvalley.net/blog/>
- Steam Store Page for *Stardew Valley*: https://store.steampowered.com/app/413150/Stardew_Valley/
- Steam Database Page for *Stardew Valley*: <https://steamdb.info/app/413150/>
- SteamSpy Page for *Stardew Valley*: <https://steamspy.com/app/413150>

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