Small Business Management Entrepreneurship and Beyond 6th edition Hatten Solutions Manual

SKU: 9781285866383-SOLUTIONS

CHAPTER 2

Small Business Management, Entrepreneurship, and Ownership

TEACHING TIPS

- Use the progressive Figures (2.1, 2.2, and 2.3) of the entrepreneurship/small business management model to explain the differences and similarities between entrepreneurs and owners of small businesses. The person is separate from the process. Begin the class discussion by asking students to describe entrepreneurs they know or have read about.
- Ask students why they want to go into business for themselves rather than work for someone else. Compare their responses to Figure 2.4.
- Use Reality Check to illustrate the vast differences in ways businesses begin.
- Ask students about traits or personal characteristics needed to be a successful entrepreneur.
- Use the case, What Would *You* Do? No.1, to help students make the choice of form of ownership for Zoo Doo (great case!).
- This chapter is a natural fit to have an entrepreneur visit class—have him/her discuss the different challenges/environments/ and problems faced at different stages of their business development (as seen in the model of Entrepreneurship/Small Business Management.)
- The chapter closing case features small business owners who are struggling with problems regarding their business model. Have students read the case setup before class and have students make a commitment on what they recommend. Then you can either begin class discussion with the whole group or break the class into groups of three or four and have them brainstorm strategies before opening discussion to all.

LECTURE OUTLINE

Opening Vignette: Sara Blakely, founder of Spanx

Sara looked for the solution to a personal problem (like most entrepreneurs do) and created flattering undergarments for females. Spanx now has a business valuation of $1Billion - and Blakely owns 100 percent of it.

Concept Module 2.1 **The Entrepreneur–Manager Relationship**

LO1 Articulate the differences between the small business manager and the entrepreneur

While there is an overlap between entrepreneurship and small business management, there are enough differences to study each separately. Entrepreneurship and small business management are both processes, not isolated incidents.

A. **What Is an Entrepreneur?**

An entrepreneur is a person who sees an opportunity and assumes the risks (financial, material, and psychological) of starting a business to take advantage of an opportunity or

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idea. Behaviors generally associated with entrepreneurship are *creation of a business; innovation of a new product, process, market, material, or organization; risk assumption; general management of the business and its resources; and performance intention of profit and/or growth.*

B. **Entrepreneurship and the Small Business Manager**
Entrepreneurship involves the startup process. Small business management focuses on running a business over a long period of time.

Entre-Perspectives

Are You Ready?

The point of this quiz is to begin discussion by comparing students' responses with responses of entrepreneurs in general. The instrument used is not intended to be predictive of who will or can become an entrepreneur—it is a compilation of entrepreneurial tendencies. The questions are designed to be thought provoking and will provide some personal insight for class discussion.

Concept Check Questions

1. **What do entrepreneurs do that distinguishes them from any other person involved in business?**

   Entrepreneurs assume the risk involved in starting businesses. The entrepreneur, unlike employees, is the one who puts forth the initial effort in creating a new business.

2. **Imagine that the principal from the high school you attended (and graduated from) called to invite you to make a presentation to the newly founded entrepreneurship club. What would you tell this group of high school students about owning their own business as a career option?**
   One could imagine talking about the commitment required for self-employment, about perseverance, about creativity and financial organization that are all needed at the same time.

Concept Module 2.2 **A Model of the Startup Process**
LO2 Discuss the steps in preparing for small business ownership

The processes of entrepreneurship and small business management can be thought of as a spectrum with six distinct stages. The entrepreneurship process includes the *innovation, triggering event,* and *implementation* stages. The small business management process includes the *growth, maturity,* and *harvest* stages. (Figure 2.1, The Startup Process illustrates the six primary stages. Figure 2.2, Environmental Factors Affecting the Startup Process shows the stages plus the different environments faced in each. Figure 2.3, A Model of the Entrepreneurship/Small Business Management Process illustrates the stages, environments, and personal, organizational, and sociological characteristics that differ from stage to stage.)

Concept Check Questions

1. **Describe the significance of triggering events in entrepreneurship. Give examples.**

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A triggering event is something that happens to the entrepreneur that causes him or her to bring an idea to reality. This is important to bring the organization to life (i.e., the loss of a job, extra income, education, job dissatisfaction)—otherwise ideas are not brought to fruition.

2. **How is small business management different from entrepreneurship?**

   Entrepreneurship involves the startup process of an organization. Small business management focuses on running a business over a long period of time.

3. **Why would an entrepreneur be concerned about harvesting a business that has not yet been started?**

   One of the keys to being effective in life is "beginning with the end in mind." Entrepreneurs don't want to start a business that is going to fail. By viewing the business as an investment and keeping in mind how to get out of it, an entrepreneur can better increase the value of a business and decrease chances of failure at the same time.

Concept Module 2.3 **Your Decision for Self-Employment**

A. Preparation for owning a small business.

B. **Pros and Cons of Self-Employment**
   Advantages and disadvantages include:

   1. **Opportunity for Independence**—Control over one's life is an attraction to self-employment. (See Figure 2.4, Independence Is the Primary Reason Most People Go into Business.)
   2. **Opportunity for a Better Lifestyle**—The ability and desire to use one's own skills and enjoy life and work more is common motivation.
   3. **Opportunity for Profit**—Few other occupations provide such a direct link between performance and compensation—strong motivation.
   4. **Risks of Self-Employment**—Personal liability, uncertain income, long working hours, and frequently limited compensation are all risks.

Reality Check

Small Biz on Campus

This box highlights students who are running their own businesses before their college graduation - good classroom discussion fodder. Ask your class if they believe this is a good idea or if they think that a student trying to go to college and start a business can't do their best at either.

For more examples see Inc.s newest Coolest Campus Startups at www.inc.com/coolest-college-start-ups-2011/index.html

C. **Traits of Some Successful Entrepreneurs**
   While personal traits and characteristics are not predictive of who will be a successful entrepreneur, some commonality exists. Important characteristics include passion for the business, determination, knowledge of product and markets, a need to achieve, internal locus of control, tolerance for ambiguity, tolerance for risk, and incredible tenacity.

'Trep Connections

Let's See It... John Goscha developing IdeaPaint

What's the point? Students will probably not recognize the company IdeaPaint, but it is an inspiring story of a successful company as a college freshman after recognizing an opportunity while working in

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a study group. The point of the story is entrepreneurial success with a business started while the owner was still in college.

D. **Preparing Yourself for Business Ownership**

1. Experience and education are both needed to start and run a business, but the type and amount of each depends greatly on the business. Entrepreneurs and small business owners have higher education levels than the general public. (See Figure 2.5, Education Level of New Business Owners.)
2. A good question can be asked here: "Can entrepreneurship be taught?" Personal traits and characteristics cannot, but the analytical and relational skills needed can be.

Concept Check Questions

1. Why might personality characteristics may be good predictors of who will be a successful entrepreneur?

Personal characteristics and traits are not useful in predicting who will be a successful entrepreneur. However, personal characteristics such as a high tolerance for ambiguity, a strong need to achieve, and a willingness to accept risk are important throughout the entrepreneurship process.

2. If a friend told you that entrepreneurs are high risk takers, how would you set the story straight?

Although there are many risks involved in entrepreneurship, financial as well as emotional, there are factors that make those risks worth taking. These include the opportunity for independence, the chance for a better lifestyle, and the potential for significant profit. Entrepreneurs, contrary to popular opinion, do not take risks just for the sake of taking them. They carefully analyze what steps can be taken to decrease the risk to a moderate level (or at least to the point where it is worth taking).

3. Explain why people who own a small business may not enjoy pure independence.

Pure independence equals total liability, and some people may not want to take this total responsibility. Owning your own business does not mean pure independence, since you still have to answer to many "bosses" like customers, employees, and regulators.

4. 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?

Although there are not any characteristics or traits that predict who would be a successful entrepreneur, studies have found shared characteristics among individuals who tend to be at the top of any profession. The most important characteristics or traits are determination, knowledge of the field, and innovation.

5. 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?

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For example, a student who has the hobby of photography – it could be turned into a business by opening a portrait studio, by selling stock photos, or by taking fashion photographs for magazine or professional sports team. Questions to answers are "Do I have enough talent to create photos that enough people will pay to get?" or "Do I have the skills to sell my photos?"

Concept Module 2.4 **Forms of Business Organization**
LO4 Describe the three main forms of ownership - sole proprietorship, partnership, and corporation - and their unique features.

A. One of the first decisions to be made in starting a business is choosing a form of ownership. There is no single best form of organization. The decision depends on individual needs and preferences, tax consequences, and liability concerns. (See the following figures: Figure 2.6, Ownership Forms of U.S. Businesses; Figure 2.7, Sales Revenue by Ownership Type; Figure 2.8, Net Income by Ownership Type; and Figure 2.9, Growth in the Business Population.)

B. **The Sole Proprietorship**
A sole proprietorship is a business that is owned and operated by one person.
1. **Advantages**—include independence, easy to set up and easy to close, and payment of taxes as an individual.
2. **Disadvantages**—include unlimited liability (you can lose more than you invest), limited resources and skills, and difficulty in continuity of the business. (See Table 2.1, Balancing the Advantages and Disadvantages of Sole Proprietorships.)

WHAT WOULD YOU DO?

Zoo Doo, a Memphis, Tennessee-based company that sells composted animal manure to gardeners

1. **Put yourself in Pierce Ledbetter's shoes (and watch where you step)! Discuss the advantages and disadvantages of organizing Zoo Doo as a sole proprietorship, a partnership, or a corporation. Think of all the possible factors that might influence your choice.**

   The advantages of Ledbetter staying a proprietorship are simplicity and stability. The disadvantage of staying a proprietorship is the biggest problem he faces (and may not even realize it) and that is of the potential liability if a customer contracted e-coli contamination from Zoo Doo (a long shot, but possible). The only advantage to bringing a partner into an existing business is if Pierce had some deficiency that only another person could provide. The disadvantage would be giving up equity and control that he had worked hard to build. The corporate advantage is providing the limited liability lacking in the proprietorship. The corporate downside is the added expense and complexity.

2. **Now that you've looked at the various ways to organize Zoo Doo, it's time to convince your management professor at Cornell University of your decision. Write a letter describing the approach you've decided to take in organizing your Zoo Doo business and why.**

   Ledbetter would most likely organize by product line and distribution channel – such as mass merchandisers, specialty garden centers, and catalog/online sales channels.

C. **The Partnership**
A partnership is an association of two or more persons who are co-owners of a business.
1. **Advantages**—include pooled talent, access to more resources, relatively easy to form, and taxes paid as individuals.

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2. **Disadvantages**—unlimited liability, potential for management conflict, less independence, and problems of continuity of the business. (See Table 2.2, Balancing the Advantages and Disadvantages of Partnerships.)
3. **The Limited Partnership**—a structure designed to increase investments and resources of a business where limited partners may retain limited liability as long as at least one general partner retains unlimited liability.
4. **The Uniform Partnership Act (UPA)**—legislation designed to settle problems that arise in partnerships.
5. **Articles of Partnership**—a contractual agreement that defines the terms and conditions, obligations, and responsibilities of partners.

D. **The Corporation**

A corporation is a business structure that creates an entity separate from its owners and managers. Many small businesses that incorporate form closely held corporations in which the stock is held by a relatively few people and is not available for sale to the general public.

1. **Advantages**—include limited liability (unfortunately, many small business owners must use their personal possessions as collateral for business loans, which effectively negates limited liability), increased access to resources, and ease of transfer of ownership.
2. **Disadvantages**—include the expense and complexity of starting and maintaining the corporation, and double taxation. (See Table 2.3, Balancing the Advantages and Disadvantages of Corporations.)
3. **Forming a Corporation**—Articles of incorporation must be filed with the Secretary of State in the state in which the business is formed. A board of directors must be appointed, bylaws adopted, officers elected, and stock issued.

Discussion topic - *The Buy-Sell Agreement*

One of the smartest documents for owners of multiple-owner businesses such as partnerships and corporations is a Buy-Sell Agreement. A buy-sell is useful if one or more of the owners wants out of the business, wants to retire, goes through personal bankruptcy, wants to sell his shares to someone else, goes through a divorce, or passes away. A good teaching moment is to do a Google search in order to bring in an example of such an agreement.

E. **Specialized Forms of Corporations**

A small business may form a C corporation, an S corporation, or a Limited Liability Company (LLC). A competent tax advisor should be consulted to assist this decision.

1. **S Corporation**—The primary advantage of an S corporation is that owners pay taxes as individuals rather than the corporation paying taxes separately. Income and expenses "flow through" to shareholders in proportion to the number of shares they own. Restrictions exist in the formation of an S corporation.
2. **Limited Liability Company (LLC)**—Owners of LLCs are taxed as partners and offer a more flexible structure than S corporations.
3. **The Nonprofit Corporation**—Nonprofit corporations are tax-exempt organizations formed for religious, charitable, literary, artistic, scientific, or educational purposes.

Concept Check Questions

1. **Sole proprietorships make up 76 percent of all U.S. businesses and generate 6 percent of all business revenue. Only 18 percent of all sole proprietorships are incorporated, but they generate 90 percent of all revenue. What do these statistics tell you about the two forms of ownership?**

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Although most businesses are proprietorships, they are smaller than corporations. Fewer companies are incorporated, but they generate the most revenue.

2. **Under what conditions would you consider joining a partnership? Why would you avoid becoming a partner?**

   Answers will vary, but students may say that they would join a partnership if they needed extra funds, physical help, or specialized skills when starting up an organization.

3. **When would forming a limited-liability company be more advantageous than creating a C corporation or a partnership?**

   A limited liability company provides more protection than a sole proprietorship and offers the advantage of compiling capital from outside sources without losing any control over management. You should choose an LLC if you need flexibility in your organization, yet still need liability protection and desire to be taxed at the partnership rate.

EXPERIENCE THIS…BONUS STUDENT EXERCISE

Do you really know what it is like to start a business? Interview a person you consider an entrepreneur to get some insight. Because time is valuable, have a set of questions prepared before the interview. The following set may be a place for you to start:

1. How did you develop a vision for your business?
2. How long did you envision this business before you took action to start it?
3. What triggering event prompted you to take action to start this business?
4. What are the most important entrepreneurial characteristics that have helped you succeed?
5. What were your biggest challenges?
6. What would you do differently the next time you start a business?

Answers to this exercise will vary based on students' findings during their interviews

CHAPTER CLOSING CASE

1. We read in this chapter that entrepreneurs try to build competitive advantages for their businesses by being unique. How will these partners know if their Fluzzle Tube idea will stand out, or sink?

Ultimately the measure of a product is if people will actually purchase it. The partners can take sequential steps to build sales like participating in trade shows to find distributors, wholesalers, and retailers to sell their Fluzzle Tubes. Of course price is always a factor for products such as Fluzzle Tubes so the partners need to look for ways in decrease their production and operating costs in order to efficiently use the revenue generated from sales.

2. Put yourself in the position of Whitehead and De Arkos. What should these partners to next?

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Student responses will vary but there should be no shortage of approaches they come up with. Lead class discussion about channels of distribution, pricing, additional product lines.

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