Bill Gates (bottom left) and Paul Allen (bottom right) with the Microsoft team in December 1978. The company, then almost 4 years old, had revenue of $1.4 million for the 1978 calendar year. For the fiscal year ended June 30, 2005, Microsoft’s revenue was almost $40 billion and it had 63,564 employees! (Source: Courtesy Microsoft) Bill Gates and Warren Buffet, the two richest men in the world—both self-made— together with Melinda Gates discuss how they will donate most of their fortunes to charity, New York City, June 2006. (Source: Spencer Platt/Getty Images News and Sports Services)

THE POWER OF ENTREPRENEURSHIP

This is the entrepreneurial age: In 2006, about half a billion people worldwide were either actively involved in trying to start a new venture or were owner-managers of a new business. More than fifteen hundred new businesses are born every hour of every working day in the United States. Entrepreneurs are driving a revolution that is transforming and renewing economies worldwide. Entrepreneurship is the essence of free enterprise, because the birth of new businesses gives a market economy its vitality. New and emerging businesses create a very large proportion of innovative products and services that transform the way we work and live, such as personal computers, software, the Internet and the Web, biotechnology drugs, overnight package deliveries, and big-box stores. They generate most new jobs. For example, from 1990 to 1994, small, growing firms with 100 or fewer workers generated 7–8 million new jobs in the U.S. economy, whereas firms with more than 100 workers destroyed 3.6 million. In 1998–1999, small business accounted for two-thirds of the 2.6 million net new jobs. And according to the most recent data, small business created all the net new jobs in the period 2000–2001.

There has never been a better time to practice the art and science of entrepreneurship. But what is entrepreneurship? Early in the twentieth century, Joseph Schumpeter, the Moravian-born economist writing in Vienna, gave us the modern definition of an entrepreneur—the person who destroys the existing economic order by introducing new products and services, by introducing new methods of production, by creating new forms of organization, or by exploiting new raw materials. According to Schumpeter, that person is most likely to accomplish this destruction by founding a new business but may also do it within an existing one.

Schumpeter was explaining how entrepreneurs had suddenly increased the standard of living of a few industrialized nations. When the industrial revolution began in England around 1760, no nation had enjoyed a standard of living equal to that of Imperial Rome 2,000 years earlier. But from 1870 to 1979, for example, the standard of living of sixteen nations jumped seven-fold on average.

Very few new businesses have the potential to initiate a Schumpeterian “gale” of creation-destruction, as Apple Computer did in the computer industry. The vast
majority enter existing markets. So in this textbook, we take a broader definition of entrepreneurship than Schumpeter’s. Ours encompasses everyone who starts a new business. Our entrepreneur is the person who perceives an opportunity and creates an organization to pursue it. And the entrepreneurial process includes all the functions, activities, and actions associated with perceiving opportunities and creating organizations to pursue them. Our entrepreneur’s new business may, in a few rare instances, be the revolutionary sort that rearranges the global economic order, as Wal-Mart, FedEx, and Microsoft have done, and Amazon.com, eBay, and Orbitz.com are now doing. But it is much more likely to be of the incremental kind that enters an existing market.

The Changing Economy

General Motors was founded in 1908 as a holding company for Buick. On December 31, 1955, General Motors became the first American corporation to make over one billion dollars in a year. At one point it was the largest corporation in the United States in terms of its revenues as a percent of GDP. In 1979, its employment in the U.S. peaked at 600,000. In April 2005, General Motors posted a $1.1 billion loss for the first quarter of the year. Its debt was downgraded to junk bond status, and it announced plans to cut 25,000 jobs in the U.S. Once the job cuts have been executed, General Motors will employ 125,000 Americans.

Wal-Mart was founded by Sam Walton in 1962. For the year ended January 31, 2006, Wal-Mart had record sales of $312.4 billion and record earnings of $11.2 billion. Sales increased 9.5% and net income 9.4%. More than 175 million customers visited Wal-Mart stores worldwide every week. During 2004, Wal-Mart added 117 stores in the U.S., and another 248 in Canada, Mexico, Brazil, Argentina, England, Germany, China, and Japan. Wal-Mart created 125,000 new jobs globally in 2004. Wal-Mart was the world’s largest corporation in 2006 with 1.3 million associates in the U.S. and a total of 1.8 million globally. It was estimated that more than 3 million American jobs were supported by Wal-Mart.

“We’re all working together; that’s the secret. And we’ll lower the cost of living for everyone, not just in America, but we’ll give the world an opportunity to see what it’s like to save and have a better lifestyle, a better life for all. We’re proud of what we’ve accomplished; we’re just begun.”


In this chapter we will look at the importance of entrepreneurship and small business to the U.S. and the global economy, describe the entrepreneurial revolution, present a conceptual model for the entrepreneurial sector of the economy and use it to explain major factors in the revolution, and compare and contrast entrepreneurial activity among nations within the context of the conceptual model.

Entrepreneurship and Small Business in the U.S.

In the U.S. there are 24 million or so businesses, of which approximately 99.5% are small businesses. In general, businesses with 500 or fewer employees are classified as small. They account for half the private sector workers and 44.3% of the private payroll, and they generate approximately half the nonfarm private gross domestic product (GDP). If the small business sector of the U.S. economy were a nation, its GDP would rank second in the world, right behind the U.S. medium-and-big-business sector, ahead of the entire economy of Japan, and far ahead of the economies of Germany, the U.K., France, and Italy.

Not only are small businesses the engine for job creation, they are also a powerful force for innovation. They employ 39% of all high-tech workers and produce approximately
Entrepreneurship and Small Business in the U.S.

14 times more patents per employee than large firms.8 Their share of U.S. research and development (R&D) grew from 5.9% in 1984 to an estimated 20.7% in 2003, with the dollar value growing from $4.4 billion in 1984 to an estimated $40.1 billion in 2003—a nine-fold increase.9

Half of the 24 million small businesses are part-time and half are full-time undertakings. Of 12 million full-time businesses, approximately 6 million have only 1 employee (the self-employed owner).10 Approximately two-thirds of the 12 million full-time businesses are unincorporated and one-third of them are incorporated.

At any one time, approximately 7 million nascent entrepreneurs in the U.S. are trying to create a new business; each has conceived an idea for a new venture and taken at least one step toward implementing his or her idea. Many of them abandon their ventures during the gestation period and never actually open their businesses; nonetheless, each year at least 3 million new ventures are born, of which about 75% start from scratch. Most of the others are purchases of existing businesses.11 Two in every 3 businesses are started in the owner’s home. Most remain tiny because they are part-time businesses, but around 600,000 have at least 1 full-time employee.

Survival rates for new businesses were the focus of several different studies.13 One of the most thorough was done by Alfred Nucci at the U.S. Census Bureau, who calculated the 10-year survival rates of business establishments.14 He found that 81% survive at least one year, 65% two years, 40% five years, and 25% ten years. The survival rate for independent startups was slightly lower. For example, the one-year rate was 79% instead of 81%. The chance of survival increased with age and size. Survival rates also varied somewhat with industry, but not as strongly as with age and size.

Of course, survival does not necessarily spell success. In general, the median income of small business owners is almost the same as that of wage and salary earners. However, the income distribution is much broader for small business owners, which means that they are more likely to have significantly less income or significantly more income than wage and salaried workers.13 But small business owners are also building equity in their companies as well as taking income from them, so it is possible that small business owners are better off overall than their wage-earning cohorts.

However, a study of business owners disposing of their businesses through sale, closure, passing it on, and other methods found that comparatively few saw their standard of living changed by their business. Only 17% reported that their business had raised their standard of living, while 6% reported the opposite.16

Small businesses are distributed throughout the U.S., but not uniformly. The proportion of full-time self-employed by state in 1999 ranged from a high of 14.9% for Alaska to a low of 7.3% for Missouri. In rural areas 10.0% were self-employed, which was almost one percentage point higher than the national average.17 In 1997, 40% of small businesses were in service industries, 20% in retail, 12% in construction, 8% in wholesale, 8% in finance, 6% in manufacturing, 4% in transportation and communications, and 2% in agricultural services.18

The new business formation index was stable through the 1950s and most of the 1960s; there was virtually no growth. By 1970, net new business formation was growing and the growth continued through the 1970s, 1980s, and into the 1990s.19 No one noticed the change at the time. One of the first documented references to what was taking

A survey by ACNielsen International Research in July 2005 found the following:12

- 58% of Americans say they’ve dreamed of starting a business and becoming their own boss.
- The most common reason for wanting to start a business is to increase one’s personal income (66% of respondents), followed by increased independence (63%).
- The primary barriers to starting a business are insufficient financial resources (cited by 49% of respondents) and satisfaction with their current situation (29%).
CHAPTER 1  The Power of Entrepreneurship

place was an article called "The coming entrepreneurial revolution" in The Economist in December 1976. In this article, Norman Macrae argued that the era of big business was drawing to an end and future increases in employment would come mainly from either smaller firms or small units of big firms. The following year, David Birch published his book Job Creation in America: How Our Smallest Companies Put the Most People to Work. The title says it all: It captures the important finding from Birch’s comprehensive study of business establishments.

No issue gets the attention of politicians more than job creation. Birch’s findings and the stream of research that ensued forever changed the attitude of policy makers to small business. Until then most of their focus had been on big business. After all, in 1953 Charles Erwin Wilson, then GM’s president, is reported to have said during the hearings before the Senate Armed Services Committee, “What’s good for General Motors is good for the country.” At the time, GM was one of the largest employers in the world—only Soviet state industries employed more people.

Entrepreneurial Revolution

On November 1, 1999, Chevron, Goodyear Tire & Rubber Company, Sears Roebuck, and Union Carbide were removed from the Dow Jones Industrial Average (DJIA) and replaced by Intel, Microsoft, Home Depot, and SBC Communications. Intel and Microsoft became the first two companies traded on the NASDAQ exchange to be listed in the DJIA.

This event symbolized what is now called the entrepreneurship revolution that transformed the U.S. economy in the last quarter of the twentieth century. Intel and Microsoft are the two major entrepreneurial driving forces in the information technology revolution that has fundamentally changed the way in which we live, work, and play. SBC (formerly Southwestern Bell Corporation) was one of the original “Baby Bells” formed after the U.S. Department of Justice antitrust action resulted in the breakup of AT&T. It is an excellent example of how breaking up a monopoly leads to entrepreneurial opportunities. And Home Depot exemplifies the big-box stores that have transformed much of the retail industry.

Intel was founded in Silicon Valley by Gordon Moore and Robert Noyce and funded by Arthur Rock, the legendary venture capitalist. Gordon Moore, the inventor of Moore’s Law, and Robert Noyce, one of the two inventors of the integrated circuit, had been at the birth of Silicon Valley with William Shockley, the co-inventor of the transistor, when Shockley Semiconductor Laboratory was founded in Mountain View in 1956. They left Shockley in 1957 to found Fairchild Semiconductor, which in 1961 introduced the first commercial integrated circuit. In 1968, they left Fairchild to start Intel.

Ted Hoff, employee number 12 at Intel, invented the microprocessor in 1968. In 1971 Intel launched the first commercial microprocessor, heralding a new era in integrated electronics. Then in 1974 it launched the first general-purpose microprocessor, the Intel 8080, which was the brain of the first personal computer, the Altair 8800—a $439 hobbyist’s kit—announced by MITS (Micro Instrumentation and Telemetry Systems of Albuquerque) on the front cover of the January 1, 1975, edition of Popular Electronics.

According to personal computer folklore, Paul Allen, then working at the minicomputer division of Honeywell in Massachusetts, hurried to his childhood friend and fellow computer enthusiast, Bill Gates, who was a Harvard sophomore, and waving Popular Electronics with a mock-up of the Altair 8800 on its front cover, exclaimed, “This is it! It’s about to begin!” Within a month or so, Gates had a version of BASIC to run on the Altair. He and Allen joined together in an informal partnership called Micro-Soft and moved to Albuquerque.

“When I was 19, I caught sight of the future and based my career on what I saw. I turned out to have been right.”
—Bill Gates
Entrepreneurship and Small Business in the U.S.

Microsoft grew steadily by developing software for personal computers. By 1979 it had moved to Bellevue, Washington, near Seattle where Gates and Allen had grown up. It then had revenue of more than $2 million and 28 employees. It got its big break in 1980–81 when, building on the core of a product acquired from Seattle Computer Products, Microsoft introduced MS-DOS for IBM’s first PC. Fourteen years later when Microsoft released Windows 95 in 1995, it sold 4 million copies in 4 days. Its success helped to move the personal computer into 250 million homes, businesses, and schools worldwide. In the early 1990s, Microsoft committed itself to adding Internet capabilities to its products. When Microsoft joined the DJIA in 1999, there were more than 200 million Internet users, up from 3 million just 5 years earlier.

SBC came about in 1984 because of the breakup of AT&T. SBC’s growth has come mainly through acquisitions, so we are not making the case that SBC itself is especially entrepreneurial. However, the breakup of AT&T did unleash a wave of entrepreneurship that produced the explosive growth of the telecommunications industry in the last 20 years. According to a recent survey, the top 5 innovations since 1980 are the Internet, cell phones, personal computers, fiber optics, and e-mail. No doubt about it, the phenomenal growth of wireless communications and the Internet would not have happened if AT&T had been allowed to keep its pre-1983 stranglehold on the telecom industry. (AT&T floundered after it was broken up. In 2004, it was dropped from the DJIA, and in 2005 it was acquired by SBC, which then adopted AT&T, Inc. as its corporate name; as a result, AT&T’s legendary “T” ticker symbol on the New York Stock Exchange returned to the DJIA.)

Home Depot was founded in 1979 by Bernie Marcus and Arthur Blank. The chain of hardware and do-it-yourself (DIY) stores holds the record for the fastest time for a retailer to pass the $30 billion, $40 billion, $50 billion, $60 billion, and $70 billion annual revenue milestones. It is the second largest retailer in the U.S., surpassed only by Wal-Mart. And it almost set the record for the fastest time from starting up to joining the DJIA when it was only 20 years old. By comparison, Wal-Mart was 35 years old when it displaced F. W. Woolworth in the DJIA. Along with Wal-Mart, Home Depot has set the pace for the retail industry in the last two decades. Together, the two account for about 3% of the nation’s GDP and 1.6 million jobs.

At the turn of the twentieth century, about 50% of the U.S. workers were employed in agriculture and domestic service. Less than 100 years later, the number was about 4%. Much of this transformation came about because innovations, many of them introduced by entrepreneurs, made agriculture a shining example of increasing productivity, and labor-saving products such as the vacuum cleaner, gas and electric ranges, washing machines and clothes dryers, dishwashers, automobiles, lawn mowers, floor polishers, processed foods, microwave ovens, and services increased the productivity of household labor. The proportion of the workforce in manufacturing grew from 19% in 1900 to 27% in 1950, thereby providing alternative employment opportunities for farm laborers and domestic workers.
By the turn of the twenty-first century, only 15% of the jobs were in manufacturing and about 40% were in service industries; the proportion of knowledge-based jobs was estimated to be more than 50%. The DJIA reflects the changing face of the U.S. economy: In 1896 the 12 companies comprising the DJIA reflected the dominance of agriculture and basic commodities; in 1928—the first time the DJIA comprised 30 companies—the members reflected the importance of manufacturing, retailing, and the emerging radio industry; and in 1999 the shift was toward knowledge-based industries.

<table>
<thead>
<tr>
<th>DJIA Companies</th>
<th>1896</th>
<th>1928</th>
<th>1999</th>
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<tr>
<td>American Cotton Oil</td>
<td>Allied Can</td>
<td>Alcoa</td>
<td>American Express</td>
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<td>American Sugar</td>
<td>Allied Chemical</td>
<td>AT&amp;T Corp.</td>
<td>Boeing</td>
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<td>American Tobacco</td>
<td>American Smelting &amp; Refining</td>
<td>Citigroup</td>
<td>Caterpillar</td>
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<tr>
<td>Chicago Gas</td>
<td>American Sugar</td>
<td>Boeing</td>
<td>Citigroup</td>
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<tr>
<td>Distilling &amp; Cattle Feeding</td>
<td>Atlantic Refining</td>
<td>Caterpillar</td>
<td>Citigroup</td>
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<tr>
<td>General Electric</td>
<td>Bethlehem Steel</td>
<td>Coca-Cola</td>
<td>Citigroup</td>
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<td>Laclede Gas Light</td>
<td>Chrylser</td>
<td>Disney</td>
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<tr>
<td>National Lead</td>
<td>General Electric</td>
<td>DuPont</td>
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<tr>
<td>North American</td>
<td>General Motors</td>
<td>Eastman Kodak</td>
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<tr>
<td>Tennessee Coal, Iron &amp; Railroad</td>
<td>General Railway</td>
<td>Exxon-Mobil</td>
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<tr>
<td>U.S. Leather</td>
<td>General Railway</td>
<td>General Electric</td>
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<td>U.S. Rubber</td>
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<td>Hewlett-Packard</td>
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<td>Mack Trucks</td>
<td>Home Depot</td>
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<td>Nash Motors</td>
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<td>North American</td>
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<td>Paramount Publix</td>
<td>Intel</td>
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<td>International Paper</td>
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<td>Radio Corporation</td>
<td>Johnson &amp; Johnson</td>
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<td>Sears, Roebuck</td>
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<td>Standard Oil (NJ)</td>
<td>Merck</td>
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<td>Texas Corporation</td>
<td>Microsoft</td>
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<td>Texas Gulf Sulphur</td>
<td>Microsoft</td>
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<td>Union Carbide</td>
<td>Morgan J.P.</td>
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<td>U.S. Steel</td>
<td>Philip Morris</td>
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<td>Victor Talking Machines</td>
<td>Procter &amp; Gamble</td>
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<td>Westinghouse</td>
<td>SBC Communications</td>
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<td>Woolworth</td>
<td>3M</td>
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<td>Wright</td>
<td>United Technologies</td>
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On April 8, 2004, International Paper, AT&T, and Eastman Kodak were replaced with Pfizer, Verizon, and AIG.

Of course, only a few of the entrepreneurial giants ever get into the DJIA, which is composed of only 30 of the most widely held stocks. The following are some of the other legendary entrepreneurs and their companies that featured in the entrepreneurship revolution of the last 30 years.

Perhaps one of the most revolutionary entrepreneurial ideas outside of high-tech industries was Fred Smith’s notion to deliver packages overnight anywhere in the U.S. Smith identified a need for shippers to have a system designed specifically for airfreight that could accommodate time-sensitive shipments such as medicines, computer parts, and
electronics in a term paper that he wrote as a Yale undergraduate. Smith’s professor did not think much of the idea and gave it a C. After tours of duty in Vietnam, Smith founded his company, Federal Express (FedEx) in 1971 and it began operating in 1973 out of Memphis International Airport. In the mid-1970s, Federal Express had taken a leading role in lobbying for air cargo deregulation that finally came in 1977. These changes allowed Federal Express to use larger aircraft and spurred the company’s rapid growth. Today FedEx has the world’s largest all-cargo air fleet, including McDonnell-Douglas MD-11s and Airbus A-300s and A-310s.28

In 1971 when Southwest Airlines began operations, interstate airline travel was highly regulated by the federal government, which had set up the Civil Aeronautics Board (CAB) in 1938 to regulate all domestic air transport as a public utility, setting fares, routes, and schedules. The CAB was required to ensure that the airlines had a reasonable rate of return. Most of the major airlines, whose profits were virtually guaranteed, favored the system. Not surprisingly, competition was stifled and almost no new airlines attempted to enter the market. However, intrastate passenger travel was not regulated by the CAB, so Southwest, following the pioneering path of Pacific Southwest Airline’s (PSA) service within California, initiated passenger service within Texas. The success of PSA and Southwest in providing cheap airline travel within California and Texas provided powerful ammunition for the deregulation of intrastate travel, which came about in 1981 as a consequence of the airline deregulation act of 1978.29 Since deregulation, more than one hundred startup airlines inaugurated interstate scheduled passenger service with jet aircraft.30 Herb Kelleher, the charismatic co-founder of Southwest Airlines, is often credited with triggering airline deregulation by persevering with his legal battle to get Southwest airborne in the face of fierce legal opposition from Braniff, Trans-Texas, and Continental Airlines. Two of those airlines took their legal battle all the way to the U.S. Supreme Court, which ruled in Southwest’s favor at the end of 1970.31

Robert Swanson was 27 when he hit upon the idea that a company could be formed to commercialize biotechnology. At that time he knew almost nothing about the field. By reading the scientific literature, Swanson identified the leading biotechnology scientists and contacted them. “Everybody said I was too early—it would take ten years to turn out the first microorganism from a human hormone or maybe twenty years to have a commercial product—everybody except Herb Boyer.”32 Swanson was referring to Professor Herbert Boyer at the University of California at San Francisco, co-inventor of the patents that, according to some observers, now form the basis of the biotechnology industry. When Swanson and Boyer met in early 1976, they almost immediately agreed to become partners in an endeavor to explore the commercial possibilities of recombinant DNA. Just seven months later, Genentech announced its first success, a genetically engineered human brain hormone, somatosin. According to Swanson, they accomplished ten years of development in seven months. Most observers say it was Swanson’s entrepreneurial vision that brought about the founding of the biotech industry. Today, there are about 1,500 U.S. biotech companies with combined revenues of more than $50 billion.

At almost the same time that Swanson was starting Genentech in southern San Francisco, not many miles away Steve Jobs and Stephen Wozniak were starting Apple Computer in Silicon Valley. Their computer, the Apple I in kit form, was an instant hit with hobbyists. The Byte Shop—the first full-time computer store anywhere in the world, which opened in Silicon Valley in December 1975—ordered 25 of them in June 1976. The owner of The Byte Shop asked Jobs to put the Apple I computer board in a case because his customers were asking for complete units, not just kits. When they did so, both Apple and The Byte Shop had a hot product on their hands. The Byte Shop grew to a chain of 75 stores. “Without intending to so, Wozniak and Jobs had launched the microcomputer by responding to consumer demand.”33
Genentech’s IPO in October 1980, followed by Apple’s IPO only two months later, signaled that something magical was stirring in the biotech and personal computer industries. It triggered a wave of venture capital investment and IPOs in both industries.

A tipping point in the infant personal computer industry was the introduction of the VisiCalc spreadsheet. Dan Bricklin conceived it when he was sitting in an MBA class at Harvard in 1978, daydreaming about how he could make it easier to do repetitive calculations. Bricklin designed the prototype software to run on an Apple II. Together with Bob Frankston he formed a company, Software Arts, to develop the VisiCalc spreadsheet. When they introduced their first version in May 1979, it turbocharged the sale of Apple computers. Subsequently, sales of IBM PCs were rocketed into the stratosphere by Mitch Kapor’s Lotus 1-2-3 worksheet.

The late 1970s and the early 1980s were miraculous years for entrepreneurial ventures in the computer industry. Miniaturization of hard-disk drives, a vital component in the information technology revolution, was pioneered by Al Shugart, first at Shugart Associates, then at Seagate Technology. Dick Eagan and Roger Marino started EMC Corporation in 1979, initially selling computer furniture, and with the seed money from that they launched into selling Intel-compatible memory. From that beginning, Eagan and Marino built EMC into a company that during the 1990s achieved the highest single-decade performance of any listed stock in the history of the New York Stock Exchange. Today it is the dominant company in the data storage industry.

Robert Metcalfe, the inventor of Ethernet, founded 3Com in 1979 to manufacture computer network products. 3Com built its business around Ethernet plug-in cards for personal computers. Today Ethernet is so widely used that it is usually built into most PC motherboards.

Michael Dell, while still a student at the University of Texas, Austin, in 1984, began selling IBM-compatible computers built from stock components that he marketed directly to customers. By concentrating on direct sales of customized products, Dell became the largest manufacturer of personal computers in the world, and Michael Dell was CEO longer than any other executive in the PC hardware industry.

Entrepreneurs were at the conception and birth of new products and services that have transformed the global economy in the last 35 years. However, what is turning out to be the biggest of them all began in 1989 when Tim (now Sir Timothy) Berners-Lee conceived the World Wide Web (WWW). We are in the midst of a revolution that is changing our lives more profoundly and faster than anyone could have imagined before the Web became operational in 1992. No major new product has been adopted as quickly by such a large percentage of the U.S. population as the Web.

**Table: Time for new technologies to reach 25% of the U.S. population**

<table>
<thead>
<tr>
<th>Technology</th>
<th>Years to 25%</th>
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<tbody>
<tr>
<td>Household electricity (1873)</td>
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<tr>
<td>Telephone (1875)</td>
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<tr>
<td>Automobile (1885)</td>
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<td>Airplane travel (1903)</td>
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<td>Radio (1906)</td>
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<td>Television (1925)</td>
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<td>VCR (1952)</td>
<td>34</td>
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<tr>
<td>PC (1975)</td>
<td>15</td>
</tr>
<tr>
<td>Cellular phone</td>
<td>13</td>
</tr>
<tr>
<td>World Wide Web</td>
<td>7</td>
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</tbody>
</table>

*Source: The Wall Street Journal, June 1997*
Web: Three Revolutions Converge

In 1989 when Tim Berners-Lee wrote a proposal to develop software that resulted in the World Wide Web, he was not the first to conceive of the idea. As far back as 1945, Vannevar Bush, proposed a “memex” machine with which users could create information “trails” linking related text and illustrations and store the trails for future reference. As it turned out, he was 50 years ahead of the technologies that were needed to implement his idea. After all, the first digital computer was then only a couple of years old. Fifteen years later, Ted Nelson, inspired by Bush’s “memex,” was the first person to develop the modern version of hypertext. He wrote—prophetically, as it turned out—in 1960:

... the future of humanity is at the interactive computer screen. ... the new writing and movies will be interactive and interlinked. ... we need a world-wide network to deliver it. ..." 35

But Nelson too was far ahead of the technology. In 1962 there were fewer than ten thousand computers in the world. They cost hundreds of thousands of dollars and were primitive machines with only a few thousand bytes of magnetic core memory, and programming them was complicated and tedious. AT&T had a monopoly over the phone lines that were used for data communication. And the ARPANET, which was the forerunner of the Internet, had not yet been conceived. 36

Berners-Lee was a 25-year-old physics graduate of Oxford University working as a consultant at CERN, the European Particle Physics Laboratory in Geneva, Switzerland in 1980, when he wrote his own private program for storing information using the random associations the brain makes. His “Enquire” program, which was never published, formed the conceptual basis for his future development of the Web. 37 In 1980, the technology existed for implementing Berners-Lee’s concept, but the power of the technology was low and the installed base of computers was tiny compared to what it would be 10 years later. By 1989 when he revived his idea, three revolutions were ready for it. They were in Digital Technology, Information Technology (IT), and Entrepreneurship. The semiconductor revolution enabled the digital revolution, which in turn enabled the IT revolution. By 1992, when the Web was released by CERN, the Internet had one million hosts, computers were 1,000 million times faster, and network bandwidth was 20 million times greater than 20 years earlier. The entrepreneurship revolution meant that there was an army of entrepreneurs and would-be entrepreneurs, especially in the U.S., with the vision and capacity to seize the commercial opportunities presented by the Web.

Development of the Web

In September 1990 Berners-Lee, then back at CERN, was given the go-ahead to write a global hypertext system. He began demonstrating prototypes of his line browser (which he called the World Wide Web) early in 1991. In mid-1992 the Web was made available by CERN. In February 1993, the National Center for Supercomputing Applications (NCSA) released the first alpha version of Marc Andreessen’s “Mosaic for X.” On April 30, 1993, CERN’s directors made a declaration that WWW technology would be freely usable by anyone, with no fees payable to CERN. By December 1994 the Web was growing at approximately 1% a day— with a doubling period of less than 10 weeks. 38

In the next 10 years, Internet usage exploded. 3 By 2005 the number of users was approaching one billion, which was almost 15% of the entire population of the world.

∗ The Internet and the World Wide Web (now usually called the Web) are two separate but related entities. However, most people use the terms interchangeably. The Internet is a vast network of networks, a networking infrastructure. The Web is a way of accessing information over the Internet. It is an information-sharing model that is built on top of the Internet.
CHAPTER 1 | The Power of Entrepreneurship

Entrepreneurship Revolution Strikes Gold

Marc Andreessen moved to Silicon Valley in 1994, teamed up with veteran IT entrepreneur Jim Clark, and incorporated Mosaic Communications (later renamed Netscape Communications). Clark put $6 million of his own money into Mosaic, and venture capitalists added another $6 million. Their intent was to create a browser that would surpass the original Mosaic. It was a classic Silicon Valley startup with programmers working 18-hour days, 7 days a week, sometimes even working 48 hours at one stretch just coding.

In October 1994, the Netscape browser was posted as a download on the Internet. In no time at all, it was the browser of choice for the majority of Web users; in December 1994 Netscape Communications began shipping Netscape Navigator, which started to produce income.

Netscape Navigator was an instant success, gaining 75% of the browser market within four months of its introduction. Netscape Communications was only 16 months old when it went public in August 1995. Its IPO was one of the most spectacular in history and made Jim Clark the first Internet billionaire. According to an article in Fortune Magazine, “It was the spark that touched off the Internet boom.”

A gold rush was underway. “Netscape mesmerized investors and captured America’s imagination. More than any other company, it set the technological, social, and financial tone of the Internet age.” A generation of would-be entrepreneurs was inspired by Netscape’s success. What’s more, corporate executives from established businesses wanted...
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Emulate Jim Barksdale, the former president of McCaw Communications, who joined Netscape’s board in October 1994, became CEO in January 1995, and made a huge fortune in just eight months. Investors—both angels and venture capitalists—hustled to invest in Internet-related startups. It seemed as if everyone was panning for Internet gold, not only in Silicon Valley but throughout the U.S., and a couple of years later throughout the rest of the world.

Netscape is a superb example of American venture capital at its best, accelerating the commercialization of innovations especially at the start of revolutionary new industries driven by technology. Venture capital was in at the start of the semiconductor and the minicomputer industries in the late 1950s and early 1960s, the biotech and personal computer industries in the late 1970s, and now it was eager to invest in what promised to be the biggest of them all, the Internet and the Web.

Venture capital is not invested exclusively in technology companies. It was in at the beginning of the overnight package delivery industry with its investment in Federal Express, at the start of major big-box retailers such as Home Depot and Staples, and the creation of new airlines including JetBlue. No wonder Jiro Tokuyama, then dean of the Nomura School of Advanced Management in Japan and a highly influential economist, stated that entrepreneurial firms and venture capital are the great advantages that you [Americans] have. By 2003 venture-capital-backed companies accounted for approximately 8.5% of jobs in the U.S. and 16% of its GDP.

The Web presented numerous opportunities that were soon being exploited by entrepreneurs. It created a huge demand for more and more capacity on the Internet, which in turn presented opportunities for hardware and software entrepreneurs. They were fortunate to find venture capitalists eager to invest in their startups. Figure 1.1 shows the number of venture capital investments in Internet-related companies and the total amount invested between 1994 and 2004; it also shows the landmark events of the IPOs of Netscape, Yahoo, Amazon.com, and eBay. The period 1996 through 2000 was a golden era for classic venture capitalists and the entrepreneurial companies they invested in. Golden both metaphorically and literally, as more and more venture capitalists and entrepreneurs seemed to have acquired the Midas touch.

Some of the financial gains from

![Figure 1.1: Venture capital investments in Internet-related companies](source: Venture Economics)
venture-capital-backed companies were indeed of mythological proportions. For instance, Benchmark Capital’s investment of $5 million in eBay multiplied 1,500-fold in just two years.\(^44\) True, Benchmark’s investment in eBay set the all-time record for Silicon Valley, but there were plenty of instances when investments increased at least a hundred-fold and in some cases a thousand-fold. With investments such as those, overall returns on U.S. classic venture capital soared, with the one-year return peaking at 143% at the end of the third quarter in 2000, compared with average annual returns in the mid-teens prior to the golden era.

During a 1999 news conference at the World Economic Forum in Davos, Switzerland, reporters pestered Bill Gates again and again with variations of the same question: “These Internet stocks, they’re a bubble?” An irritated Bill Gates finally confronted the reporters, “Look, you bozos, of course they’re a bubble, but you’re all missing the point. This bubble is attracting so much new capital to the Internet industry, it is going to drive innovation faster and faster.”\(^45\)

But the gold rush came to an end in 2000. The Internet bubble burst. Many companies failed, others were forced into fire-sale mergers, investors were hammered, many jobs were lost, and doom and gloom was pervasive. There was much hand-wringing about the incredible wastefulness of the U.S. method of financing new industries. However, by August 9, 2005—the tenth anniversary of Netscape’s IPO—some companies founded during the gold rush were thriving. The market capitalization of just four of them—Google, eBay, Yahoo, and Amazon.com—was about $200 billion, which handily exceeded all the venture capital invested in all the Internet-related companies through 2000; what’s more, it even topped the combined amount raised from venture capital and IPOs. Granted, there were many more losers than winners, but five years after the bust, it was clear that the U.S. society as a whole had already benefited mightily and the best was yet to come. No doubt about it, entrepreneurs and their financial backers had put the U.S. in a dominant position globally when it came to Internet-related products and services.

Causes of the Entrepreneurial Revolution

The U.S. has always been a nation of entrepreneurs. But why has it become more and more entrepreneurial since the end of the 1960s—what is now called the entrepreneurial revolution?

First we need to step back and look at the U.S. economy in the decades before the 1970s. The Great Depression that followed the stock market collapse of October 1929 had an enormous effect on society. By 1932, when Franklin Roosevelt was elected president, over 13 million Americans had lost their jobs and the gross national product had fallen 31%. The Roosevelt administration implemented many policies to try and bring the nation out of the Depression, but it was not until World War II that the nation once again started to become prosperous. The end of the war in 1945 heralded an era of economic growth and opportunity. But the memories left by the Depression meant that workers preferred secure jobs with good wages and benefits that medium and big companies offered. And big business was booming.

The late 1940s and the 1950s and 1960s were the era of the corporate employee. They were immortalized by William Whyte in *The Organization Man*,\(^46\) in which he “argued in 1956 that American business life had abandoned the old virtues of self-reliance and entrepreneurship in favor of a bureaucratic ‘social ethic’ of loyalty, security and ‘belongingness.’ With the rise of the postwar corporation, American individualism had disappeared from the mainstream of middle-class life.”\(^47\) The key to a successful career was “Be loyal to the company and the company will be loyal to you.” Whyte’s writing assumed the change was permanent and it favored the large corporation.
Causes of the Entrepreneurial Revolution

Big American businesses were seen as the way of the future, not just in the U.S. but worldwide. John Kenneth Galbraith’s seminal book *The New Industrial State* and Jean-Jacques Servan-Schreiber’s *Le Défi Américain* (The American Challenge), both “became the bible to advocates of industrial policies” supporting big business. Both books were instant best sellers. *Le Défi Américain* sold 600,000 copies in France alone and was translated into 15 languages. Galbraith wrote in 1967, “By all but the pathologically romantic, it is now recognized that this is not the age of the small man.” He believed that the best economic size for corporations was “very, very large.”

The works of Whyte, Galbraith, and Servan-Schreiber were required reading in universities through the 1970s. Schumpeter’s work was hardly ever mentioned, and when it was, it was his book *Capitalism, Socialism, and Democracy* published in 1942, in which he was very pessimistic that capitalism would survive. Unlike Karl Marx, who believed the proletariat would bring about the downfall of capitalism, Schumpeter reasoned that the very success of free enterprise would create a class of elites who would favor central control of the economy and thereby curb free enterprise. His first book, *The Theory of Economic Development*, originally published in German in 1911, in which he endorsed entrepreneurship, was hardly ever mentioned. What’s more, in the 1970s there was an abundance of university courses dealing with Karl Marx and almost none dealing with entrepreneurship. It’s not surprising that the world was first alerted to the entrepreneurial revolution by a journalist, Norman Macrae, rather than by an academic scholar. About a decade later, researchers confirmed retrospectively that entrepreneurial activity had indeed been on the increase in the U.S. in the 1970s.

Entrepreneurship did not disappear in the 1930s, 1940s, 1950s, and 1960s; it simply did not grow very much. What brought about the change in the economy that stirred up entrepreneurship around 1970? To try to understand what changes were taking place we need to look at the social, cultural, and political context of an economy. A framework for this perspective is presented in Figure 1.2, the Global Entrepreneurship Monitor (GEM) model for the economy.

The central argument of the GEM model is that national economic growth is a function of two sets of interrelated activities: those associated with established firms and those related directly to the entrepreneurial process. Activity among established firms explains only part of the story behind variations in economic growth. The entrepreneurial process may also account for a significant proportion of the differences in economic prosperity among countries and among regions within countries.

When looking at the nature of the relationship between entrepreneurship and economic growth, it is important to distinguish between entrepreneurial opportunities and entrepreneurial capacity. What drives entrepreneurial activity is that people perceive opportunities and have the skills and motivation to exploit them. The outcome is the creation of new firms and, inevitably, the destruction of inefficient or outmoded existing firms. Schumpeter’s process of creative destruction is captured in the model by business churning. Despite its negative connotation, creative destruction actually has a positive impact on economic growth—declining businesses are phased out as startups maneuver their way into the market. These dynamic transactions occur within a particular context, which the GEM model calls *Entrepreneurial Framework Conditions* and which include factors such as availability of finance, government policies and programs designed to support startups, R&D transfer, physical and human infrastructure, education in general, education and training for entrepreneurship, social and cultural norms, and internal market openness.
CHAPTER 1 | The Power of Entrepreneurship

Now let’s look at some of the major changes in the framework conditions that have fueled the entrepreneurial revolution.

**Cultural and Social Norms.** First let’s consider the most important components, the entrepreneurs themselves. In the 1960s a generation of Americans born in the late 1930s and the 1940s—including the first baby boomers—came of age. They had no first-hand memory of the Great Depression. When they were growing up, the economy was doing well most of the time, so they really had not experienced hard times like their parents had endured. Hence, they were not as concerned about job security. Many were even rebelling against large corporations, some of which were seen as members of the military-industrial complex that was supporting the very unpopular war in Vietnam; some companies were trading with South Africa where apartheid still prevailed; and others were under attack by consumer activists such as Ralph Nader. It was a generation of Americans who were better educated than their parents, and for them starting a new business was a credible career.

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**Figure 1.2**

GEM model of economic growth

Changes in the Entrepreneurial Framework Conditions

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The Fortune 500 employed 20% of the workforce in the 1960s. That percentage began to decline in 1980 and has declined every year since then, down to about 10% by 2005. Hence, jobs in big companies became scarcer. Many companies downsized, and according to George Gendron, who was the publisher of *Inc. Magazine* during the 1980s and 1990s, 20% of downsized executives started businesses. Gendron also suggested that some of the executives who were retained—often the “best and the brightest”—became disillusioned by their career prospects in stagnant companies, and that led to a “second exodus” that produced more entrepreneurial activity.58

Other important social changes boosted entrepreneurship in the 1990s. More women became business owners, and the proportion of Asian-owned firms increased, as did Hispanic-owned and African-American-owned firms. According to Gendron, for people with limited options in employment, entrepreneurship represents the “last meritocracy.”

**Government.** The 1970s was the decade when Washington bailed out Penn Central Railroad, Lockheed, and Chrysler. Washington seemed more concerned with big business than with small. But it did recognize the need to pay attention to startups with high potential, especially the ones funded by venture capitalists. There had been a burst of venture-capital-backed startups in the last half of the 1960s. But in the early 1970s venture capital dried up to a trickle. Looking back from the perspective of the late 1990s, when $10 billion of new money flowing into the industry seemed routine, it is scarcely believable that only $10 million of new money was committed in 1975. Congress took urgent steps in 1978 to stimulate the venture capital industry, including reducing the capital gains tax and easing the ERISA prudent man rule, which had inhibited pension funds from investing in venture capital funds. The pension floodgates opened and the inflow of venture capital increased to $4.9 billion by 1987. Likewise, venture capital invested in portfolio companies increased from a low of $250 million in 1975 to 3.9 billion in 1987—a 16-fold increase.59

The government asserted its role of ensuring market openness by minimizing anti-competitive behavior. We’ve already mentioned that legislation toward the end of the 1970s deregulated the airfreight and airline passenger industries. That was followed in the early 1980s by the Justice Department’s move to break up AT&T’s monopoly.

The government deserves immense credit for its funding of R&D in government, universities, and corporations, both directly and indirectly through purchases of products. Its support was vital in the development of the computer, communications, biotech, and many other industries. Washington initiated the Small Business Innovation Research (SBIR) program in 1983 to ensure that small businesses shared some of the federal R&D dollars for new technology-based developments. In 2002, a total of 5,820 awards totaling $1.43 billion went to small businesses as a result of the SBIR program. In general, funds awarded under the SBIR program go to develop new technologies that are high-risk and high-reward. Some might say it is pre-venture capital money. From that viewpoint, $1.43 billion is a big sum when compared with just $352 million that venture capitalists invested in seed-stage technology companies in 2002. A total of $13.6 billion has been awarded over the 19 years of the SBIR program through 2002.60

**R&D transfer.** Commercial development of intellectual property resulting from federally funded research is a major benefit to the U.S. economy. It was given a major boost by the passage of the Bayh-Dole Act, implemented in 1980. The primary intent of that law was to foster the growth of technology-based small businesses by allowing them to own the patents that arose from federally sponsored research. Under Bayh-Dole, universities were allowed to grant exclusive licenses—a feature that was regarded as crucial if small businesses were to commercialize high technologies that were inherently risky propositions.61
Before 1980, U.S. universities were granted about 300 patents a year. In 2003, they applied for about 10,000. In 1980, 25 to 30 universities had offices for technology transfer. Today more than 1,200 do. The Economist magazine hailed Bayh-Dole as "the most inspired piece of legislation to be enacted in America over the past half-century." The Economist estimated that Bayh-Dole had created 2,000 new companies, 260,000 new jobs, and contributed $40 billion annually to the U.S. economy. That assessment was made in 1998 and more progress has been made since then.

The government itself has technology transfer offices at most of its research laboratories, and many large companies have licensing offices. IBM, for example, which annually spends about $5 billion on R&D, was granted 5,248 patents in 2004. It generates about $1 billion annually from licensing intellectual property, which comprises both patents and copyrights.

**Fruits of Federally Funded R&D**

The success of Bayh-Dole goes far beyond the efforts of Bob Dole and Birch Bayh. This legislation combined the ingenuity and innovation from our university laboratories with the entrepreneurial skills of America’s small businesses. Most importantly, this combination created the incentive necessary for private investment to invest in bringing new ideas to the marketplace. The delicate balance of ingenuity, entrepreneurship, and incentive upon which the success of Bayh-Dole has depended must not be disrupted.

A few of the products which have been produced in the last six years are:

- Taxol, the most important cancer drug in 15 years, according to the National Cancer Institution.
- DNA sequencer, the basis of the entire Human Genome Project.
- StormVision, which airport traffic and safety managers use to predict the motion of storms.
- Prostate-specific antigen test, now a routine component of cancer screening.
- V-Chip, which allows families to control access to television programming.

Statement of Senator Birch Bayh to the National Institutes of Health, May 25, 2004

**Physical Infrastructure.** The biggest change in entrepreneurship in the last ten years is due to the Web, the great equalizer. Small businesses now have at their fingertips a tool so powerful that it is leveling the playing field. Big businesses no longer enjoy as many scale economies as they did before the Internet. Information that could have been gathered only by a multitude of market researchers can now be found with a search engine and a couple of clicks of a mouse. Entrepreneurs don’t have to spend a fortune to reach customers with print, radio, and television advertising; they can target their potential customers via the Web. When they want to find a vendor, the Web is there to help them; likewise when they are seeking employees, bankers, and investors. Furthermore, the cost of communications of all kinds (except snail mail) has plummeted since AT&T was broken up. A long-distance telephone call that cost 40 cents a minute in 1980 now can be made for as little as 1 cent. And if small-business persons need to travel by air, they can shop the Web to find the cheapest ticket, automobile rental, and hotel room.

The worldwide distribution of goods and services is now open to everyone. Just consider what eBay has already done to change the entrepreneurial landscape. According
Causes of the Entrepreneurial Revolution

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to a 2005 study by ACNielsen International Research, 724,000 Americans report that selling on eBay is their primary or secondary source of income. An American entrepreneur can sell merchandise to a customer anywhere in the world; PayPal (founded in 1998 and now part of eBay) can ensure that the entrepreneur receives payment speedily and securely online; the merchandise can be delivered to the buyer within a day or so via FedEx; and buyer and seller can track the shipment online at each step of its journey.

Outsourcing of services and goods makes companies more efficient and effective. Entrepreneurs can now focus on their company’s core competency and let vendors take care of noncore items such as payroll, Web hosting, telemarketing, manufacturing, and distribution. There are even companies that will help entrepreneurs find outsource partners. Outsourcing enables small businesses to act like big ones, and some small companies are even called virtual companies because they outsource so much of their work.

For some entrepreneurs, business incubators combine many of the advantages of outsourcing. Incubators provide not only physical space but also shared services. Many incubators also provide ready access to human infrastructure. In 1980 there were only 12 business incubators in the U.S.; over the period between 1985 and 1995 the number of incubators in the U.S. grew 15-fold, from 40 to nearly 600—and by 2003 there were some 850 incubators. The National Business Incubation Association (NBIA) estimated that North American incubator resident and graduate companies had created about half a million jobs since 1980. (A “resident company” is one that is still in an incubator; a “graduate company” is one that has left it.) In 2001 alone, North American incubators assisted more than 35,000 startup companies that provided full-time employment for nearly 82,000 workers and generated annual revenue of more than $7 billion.

Human Infrastructure. Access to human infrastructure is as important as access to physical infrastructure—maybe more so. The human infrastructure for entrepreneurs grew rapidly in the last twenty years or so, and gaining access to it has never been easier. Thirty years ago, starting a new venture was a lonely pursuit, fraught with pitfalls that would have been avoided by someone with prior entrepreneurial experience. Today, numerous entrepreneurship experts gladly help people who are starting or growing companies. There are support networks, both informal and formal, of professionals who know a lot about the entrepreneurial process. Just search the Web for “entrepreneur AND assistance AND your town,” and you might be astonished by the number of hits.

Education, Training, and Professionalization. Entrepreneurship education and training is now readily available, part of the professionalization of entrepreneurship.
that has taken place over the last 20 years.69 According to Gendron, a body of knowledge and skills has developed over the last 20 years to enhance the chances of entrepreneurial success. A good illustration is the widely dispensed advice that would-be entrepreneurs should write a business plan before they launch their new ventures. The world of entrepreneurship is awash with information about business plans. The field has come a long way since the pioneers of entrepreneurship training put writing a business plan at the core of their programs in the 1970s.70

When Babson College and the University of Texas started their internal business plan competitions in 1985, only a few schools had entrepreneurship courses. Today more than 60% of four-year colleges and universities have at least one entrepreneurship course, and many have entrepreneurship centers. Today, entrepreneurship training courses are readily available to all sectors of the population.

The Accidental Entrepreneur

Like many other scientists and engineers who have ended up founding companies, I didn’t leave Caltech as an entrepreneur. I had no training in business; after my sophomore year of college I didn’t take any courses outside of chemistry, math, and physics. My career as an entrepreneur happened quite by accident.

Financial. Raising money for a new business is seldom easy, but the process of raising startup and expansion capital has become more efficient in the last 20 years or so. In 1982, for instance, an economist at the National Science Foundation stated that venture capital was shrouded in empirical secrecy and an aura of beliefs.72 The same held true for angel investing. In contrast, today there is an abundance of help. The amount of venture capital under management has grown from $3.7 billion in 1980 to more than $250 billion in 2005.73 We do not have reliable numbers for business angel investors, but we do know that informal investors—everyone from parents to external business angels—now invest about $100 billion annually in startup and baby businesses. Furthermore, informal investors are ubiquitous. Five percent of American adults report they “invested” in someone else’s venture in the last three years.74 It is impossible to claim that the availability of financing has driven the entrepreneurial revolution, but it does appear that sufficient financing has been available to fuel it.

Churning and Economic Growth

Technological change, deregulation, competition, and globalization presented countless opportunities, which American entrepreneurs seized and commercialized. It caused a lot of churning, or Schumpeter’s creative destruction. But 11 new businesses with employees were started for every 10 that died over the decade 1990–2000.75 It is this churning that gives the economy its vitality: only a society that willingly adapts to change can have a dynamic economy.
Causes of the Entrepreneurial Revolution

We can find examples of churning in every industry that is not a monopoly or a regulated oligopoly. Who can recall VisiCalc or for that matter Lotus 1-2-3? At the height of their fame they were two of the most widely used software packages for PCs. Today, Excel is the spreadsheet of choice. In one week alone in May 1982, when Digital Equipment Corporation (DEC) introduced its ill-fated Rainbow PC, four other companies introduced PCs. At the peak of the PC industry frenzy in the early 1980s, more than 200 companies had either introduced PCs or were planning to do so. Only a handful of PC manufacturers exist today. DEC, which in 1982 was the second-largest computer manufacturer in the world, was eventually bought by Compaq, which in turn merged with Hewlett-Packard. In 2004, IBM sold its PC division to Lenovo, a company founded in 1984 by a group of academics at the government-backed Chinese Academy of Sciences in Beijing.

Not only did the advent of the PC churn up the entire computer industry, it virtually wiped out the typewriter industry. And it changed the way office work is organized. Secretaries had to learn computer skills or they were out of work. More examples of churning: Southwest Airlines is now the most successful U.S. airline; two of its giant rivals in 1971 no longer exist, and the third, Continental, has been bankrupt twice, in 1983 and 1990. In August 2005, United Airlines, US Airways, Hawaiian Airlines, ATA Airlines (also known as American Trans Air), and Aloha Airlines were all in Chapter 11 bankruptcy, and only a handful of the 100 or so passenger airlines started up since deregulation are still around. Who goes to a travel agent to get a regular airline ticket or book a hotel room today? Where is the fax machine headed? Likewise video stores and CD retailers? Why are newspapers laying off workers? Who is buying a film camera? And even entrepreneurship academics should watch out. Donald Trump, building on his TV success with The Apprentice, has started Trump University to teach—what else?—entrepreneurship.

Granted, churning causes a lot of disruption, and nowhere more than in the lives of those who lose their jobs as a result. But overall, society is the beneficiary. Entrepreneurship produces new products and services, it increases productivity, it generates employment, and in some cases it keeps inflation in check. Economists estimate that Wal-Mart alone knocked 20%—perhaps as much as 25%—off the rate of inflation in the 1990s. According to Alfred Kahn, the father of airline deregulation, airline passengers are now saving $20 billion a year. With Skype and the Internet, you can talk to anyone, anywhere in the world for free. Forever. In August 2005, the U.S. economy was robust. The GDP was growing at 3.5% and unemployment was about 5%. Much of its vigor was the result of churning in the economy. The Times of London observed, “There are global lessons in the discomfitting success of the U.S. economy. Creative destruction not only produces winners and losers; it makes even the winners nervous. The natural human instinct is to want to shelter from such turmoil. But the real winners will be the ones who embrace it.” However, not everyone thought that the U.S. model was the desirable way to economic growth. President Jacques Chirac and his Prime Minister, Dominique de Villepin, struggling to invigorate France’s stagnant economy, didn’t much care for the “Anglo-Saxon” model of unfettered competition. Villepin, on taking office in mid-2005, said, “I am profoundly attached to...
the French social model. Less than six months later, rioting broke out in poor neighborhoods populated largely by North Africans where youth unemployment was often 40% or higher; it spread throughout France and continued for two weeks. The protests caused a three-month, nationwide state of emergency.

Next we will look at how other nations as well as the U.S are faring with entrepreneurship.

Global Entrepreneurship Monitor

The Global Entrepreneurship Monitor was conceived in 1997 to study the economic impact and the determinants of national-level entrepreneurial activity. With its coverage of more than 50 countries worldwide, GEM is the largest coordinated research effort ever undertaken to study population-level entrepreneurial activity. Member nations comprise approximately 95% of the world’s GDP and two-thirds of its population. Because of its worldwide reach and rigorous scientific method, GEM has become the world’s most influential and authoritative source of empirical data and expertise on the entrepreneurial potential of nations.

The main objectives of GEM are to gather data that measure the entrepreneurial activity of nations and other data related to entrepreneurial activity; to examine what national characteristics are related to levels of entrepreneurial activity; and to explain how differences in entrepreneurial activity are related to different levels of economic growth among nations.

GEM distinguishes between two types of entrepreneurial activity.

- **Nascent entrepreneurs** are individuals who are actively trying to start a new business but who have not yet done so.
- **Baby business managers** are owner-managers of a new business that is no more than 42 months old.

There are three main measures of entrepreneurial activity.

- **TEA (total entrepreneurial activity)** is the percent of the adult population that are either nascent entrepreneurs or baby businesses owner-managers or both. It measures the overall entrepreneurial activity of a nation.
- **TEA (opportunity)** is the percent of the adult population that are trying to start or have started a baby business to exploit a perceived opportunity.
- **TEA (necessity)** is the percent of adults who are trying to start or have started a baby business because all other options for work are either absent or unsatisfactory.

GEM in itself is an example of not-for-profit (social) entrepreneurship. It was conceived in 1997 by Babson College and London Business School professors. It was prototyped with bootstrap funding and volunteers, and was officially launched in 1998 with research teams from 10 nations and supported with funding raised by each team from national sponsors. By 2006 it has evolved into an international consortium of more than 200 researchers from more than 50 nations with a combined annual budget of about $4 million. It produces annual global reports on the overall state of entrepreneurship in those nations, country-specific reports, reports on special topics such as women entrepreneurship, financing, and job creation. More than 100 global and regional reports can be read and downloaded at www.gemconsortium.org.
Principal Findings from GEM

The total entrepreneurial activity by country in 2004 is shown in Figure 1.3. The total entrepreneurial activity varied from a low of 2.5% to a high of 40% for adults 18 to 64 years old. The average level was 9.3% or one adult in eleven.

The vertical bars in Figure 1.3 are 95% confidence intervals. The error bars are wide for some countries and narrow for others because of different sample sizes. Germany, Spain, Sweden, and the United Kingdom have narrow bars because the samples were very large. Where bars overlap there is no statistical difference among those nations. For example, among countries with lower TEA rates, Slovenia, Hong Kong, and Belgium have comparable levels of entrepreneurial activity; among the more active countries, the United States, Argentina, Australia, Brazil, Iceland, and New Zealand have comparable TEA rates.

GEM defines two types of entrepreneurship: opportunity based and necessity based. In general, nations with high per capita income have proportionately less necessity-pushed entrepreneurial activity and more opportunity-pulled, and vice versa for nations with low income, as shown in Figure 1.4. People in higher-income nations tend to have more opportunities for employment and stronger safety nets like social welfare programs, especially for the out-of-work; hence, proportionately fewer are pushed into entrepreneurship to support themselves and their families. The relatively high R-squared of 57% confirms that much of the variation in the ratio of opportunity-to-necessity entrepreneurship among nations is accounted for by differences in per capita income.

The relationship between the TEA rate and per capita income (see Figure 1.5) is U-shaped, indicating that as nations become more prosperous, entrepreneurial activity declines, bottoms out at around $22,000 per capita with GDP converted to Purchasing Power Parity (PPP) rather than raw GDP, and then increases. A possible explanation is that as a nation makes the transition from a less-developed nation to a developing nation,
R² is the proportion of the variation that is explained by the trend line. An R² of 0.57 indicates that 57% of the variation TEA (Opportunity)/Tea (Necessity) ratio is explained by GDP per capita.

**Figure 1.4**

**TEA (opportunity)/TEA (necessity)—2004**

R² is the proportion of the variation that is explained by the trend line. An R² of 0.49 indicates that 49% of the variation TEA index is explained by GDP per capita in PPP.

**Figure 1.5**

**TEA vs. GDP per capita in PPP—2005**
there are more opportunities for employment with established businesses, hence entrepre-
neurship, especially necessity-driven, declines. Entrepreneurial activity bottoms out and
then increases again as more and more opportunities, particularly in service and knowledge-
based industries, are spotted by entrepreneurs with the skills and motivation to develop
them. Note that 14 European Union (EU) countries, including France, Germany, and
Italy, are clustered very close together below the trend line, whereas 6 countries with
Anglo-Saxon economic systems—Australia, Canada, Ireland, New Zealand, U.K., and
the United States—are either above the trend or fall right on it.

Age
Young people between 25 and 34 years of age are the most entrepreneurially active group
of the population regardless of the wealth of the country (see Figure 1.6). After the age of
35, all populations show a steady decline in entrepreneurial activity. This indicates that age
is an important factor in the decision to become an entrepreneur. A nation’s demographic
structure has a significant impact on the immediate level of entrepreneurial activity in the
short term, and demographic change has a significant impact on entrepreneurial activity
in the long term.

Different income groups* have markedly different entrepreneurship activity levels
across all age groups. Low-income countries have the highest activity levels across all age
groups, ranging from 1 person in every 5 (for the 25–34-year-old group), down to 1
person in 10 among 55–64 year olds. However, the level of necessity entrepreneurship is
higher in low-income countries and is also very high among the younger age groups in
those countries, where better opportunities for employment are scarcer.

Among the three income categories, low- and high-income nations have higher levels
of entrepreneurial activity across all age groups than middle-income nations have. Low-
income countries experience roughly three times the level of activity across all age groups

* Low-income ≤$10,000 per capita annually; middle income>$10,000 ≤$25,000; high income>$25,000.
as do middle-income countries; the difference between high-and middle-income countries is less.

The difference between the level of activity of the 25–34-year-old group and that of the 35–44-year-old group in high income nations is notable (a TEA of 12.45 compared with 7.9 for the older group). This result is consistent with the observation that an entrepreneurial revolution has been taking place in the United States, and perhaps in other high-income countries where the 1990s witnessed an ever-increasing number of 25–34-year-olds actively engaged in starting businesses.86

**Gender**

Almost 50% more men than women are entrepreneurially active. These differences are consistent across age groups and across most countries. In no country are women more entrepreneurially active than men, but there is wide variation among countries.

In 2004, France, Greece, Hong Kong, and Spain all showed large gender gaps in entrepreneurial activity, while in Ecuador, Finland, Hungary, Japan, Peru, South Africa, and the United States participation rates were statistically identical (see Figure 1.7). The narrower gaps in this last group of countries may be the result of two different sets of circumstances. First, the ratio of female to male entrepreneurs is higher in the case of necessity-based entrepreneurship, which constitutes a high proportion of activity in the low-income countries (Ecuador, Hungary, Peru, and South Africa). Second, for high-income countries such as Finland and the U.S., the closing gender gap may be the result of targeted programs, cultural changes, and more emphasis on entrepreneurial

![Figure 1.7](image-url)
Principal Findings from GEM

Education

It’s widely believed that levels of educational attainment have implications for entrepreneurial behavior. Figure 1.8 shows the relationship between entrepreneurship and less than secondary education, secondary education, and post-secondary education for each of the three income groups. Secondary education refers to young people roughly between the ages of 12 and 18.

The wide differential between the educational profiles of entrepreneurs in low and high-income countries is obvious. In high-income countries, 57% of entrepreneurs have a post-secondary education, suggesting that in these countries the education systems are tending to build skills for entrepreneurs. In the poorest countries, only 23% of entrepreneurs have a post-secondary education. On the other hand, almost half of entrepreneurs in low-income nations have not completed secondary education; this is the case for only 13% of their high-income counterparts. In the middle-income countries, the best and least-educated fall between these two extremes and exhibit a slight tendency toward the better-educated end of the continuum.

Financing

Entrepreneurial activity and financing go hand in glove, so it is no surprise that in general they are correlated. There are two main types of financing for new ventures: equity and debt. As a general rule, equity financing has to come before debt, particularly borrowing from a bank. Hence, GEM focuses on equity financing, which is informal investments from the

---

* What appears to be a closing gender gap may possibly be the result of sample bias. For example, in Japan the overall level of activity is very low, resulting in large standard errors, which make statistically significant gender differences hard to capture.
entrepreneurs’ families and friends, business angels, and, on rare occasions, formal venture capitalists. The combined amount of informal investment and venture capital as a percent of GDP is shown in Figure 1.9. In Chapter 9, we will discuss GEM financing in detail.

**Job Creation**

We will now look at the prevalence of high-growth expectations among both nascent entrepreneurs and baby businesses, as identified in GEM’s adult population surveys from the years 2000 to 2004.

The following definitions apply:

- **High-expectation nascent entrepreneur** is an individual who expects to employ at least 20 employees within five years’ time through his or her new firm.
- **High-expectation baby business** is a new firm up to 42 months old that aims to employ at least 20 employees within five years’ time.

The term “high-expectation” emphasizes the fact that the GEM data are based on expected rather than actual job creation.

Only 5.4% of the adult-age population in the GEM 2000–2004 countries were active in nascent and baby businesses that expected to employ 2 or more employees in 5 years’ time; and only 2.7% of the adult-age population expected to have 5 or more employees. For the growth expectations of 10+, 20+, and 50+, the percentages drop to 1.6, 0.8, and 0.4. In other words, fewer than 1 person in every 100 is involved with a nascent or baby business that expects to create 20 or more jobs in 5 years. And only 4 of 1,000 expect to create 50 or more jobs. Hence, expectations of rapid growth are rare.
The rate of high-expectation entrepreneurial activity varies significantly among world regions and individual countries. The regions with the highest participation rate in high-expectation entrepreneurial activity (see Figure 1.10) are North America (Canada and the U.S.) and Oceania (Australia and New Zealand). For these regions, the rate of high-growth entrepreneurial activity ranges from approximately 1.1% to 1.6%. The lowest rate of high-expectation activity is observed for European and highly developed Asian countries (Hong Kong, Korea, Japan, and Singapore), where it is approximately 0.5%.

The prevalence rate of high-expectation entrepreneurial activity is worryingly low in Europe and highly developed Asia. There are no differences among European country groups (large EU countries, small European countries, new EU member countries), even though there are differences between individual countries. The United Kingdom and Germany’s participation rates are approximately 0.7%, which is about half the U.S. level. Sweden’s participation rate of 0.5% is lower than in the United Kingdom or Germany, but double that of Spain (0.2%), which has the lowest participation rate.

Although GEM data are for expected job creation, they are consistent with empirical studies of actual job creation. For instance, one study found that 4% of new firms in the United Kingdom created 50% of all jobs created by all new firms. Another study reported that more than 70% of the employment growth in the United States came from only 3% of all firms.

**Twenty-First Century Economies: Anglo-Saxon or Social Models?**

It is very interesting that a group of nations with so-called Anglo-Saxon economic systems (Australia, Canada, Ireland, New Zealand, the United Kingdom, and the U.S.) has a high
prevalence rate of high-expectation entrepreneurial activity, which translates into more job creation. Nations in that group had unemployment rates around 5% or lower in 2005, except for Canada, where unemployment was above 6%. It is a finding that President Jacques Chirac and his prime minister might chew over as they hunt for policies to get the French economy out of the doldrums, with unemployment stuck around 10% in August 2005.

Here is the United Kingdom’s Prime Minister Tony Blair’s challenge for Europe in his address to the European parliament in June 2005.

What would a different policy agenda for Europe look like? First, it would modernize our social model. Again some have suggested I want to abandon Europe’s social model. But tell me: what type of social model is it that has 20 million unemployed in Europe, productivity rates falling behind those of the USA, that is allowing more science graduates to be produced by India than by Europe, and that, on any relative index of a modern economy—skills, R&D, patents, IT—is going down not up? India will expand its biotechnology sector five-fold in the next five years. China has trebled its spending on R&D in the last five.

Of the top 20 universities in the world today, only 2 are now in Europe. Of the top 20 universities in the world today, only 2 are now in Europe. The purpose of our social model should be to enhance our ability to compete, to help our people cope with globalization, to let them embrace its opportunities and avoid its dangers. Of course we need a social Europe. But it must be a social Europe that works.

And we’ve been told how to do it. The Kok report in 2004 shows the way. Investment in knowledge, in skills, in active labor market policies, in science parks and innovation, in higher education, in urban regeneration, in help for small businesses. This is modern social policy, not regulation and job protection that may save some jobs for a time at the expense of many jobs in the future.

Early in 2006, Dominique de Villepin, France’s prime minister, proposed legislation aimed at curbing chronic youth unemployment by easing rigid labor laws that make it very difficult to fire employees. Students rose up all over France to protest the proposed changes and shut down classes at half of France’s 84 state-run universities in the biggest student uprising since 1968 (when student riots forced the de Gaulle government to hold an election). The students’ attitude in 2006 was summed up by these comments.

Elodie, 21, a sociology student, said, “The issues are different from those our parents were protesting about. We are marching for the right to proper jobs.”

Romain, 20, a communications student, said, “We don’t want the Anglo-Saxon economic model here.”

A survey discovered that the top career goal of three-quarters of young French people was to be a civil servant. This is in stark contrast to the U.S., where the majority of young people want to be an entrepreneur at some time during their careers.

CONCLUSION

Entrepreneurial activity in the United States now accounts for much of the nation’s prosperity and its competitiveness in the global economy. The disappearance of “old”
jobs, particularly in mature manufacturing industries, and their replacement by “new” jobs, especially in service and knowledge-based industries, is disconcerting to workers whose jobs are threatened. But society has to accept churning—the creation of new enterprises and the destruction of obsolete ones—because it gives the U.S. economy its vitality.

The entrepreneurial framework includes factors such as availability of finance, government policies and programs designed to support startups, R&D transfer, physical and human infrastructure, education in general, education and training for entrepreneurship, social and cultural norms, and internal market openness. All of these factors combined determine the degree of entrepreneurial activity in a nation, or for that matter in a region within a nation. Among the large developed nations, the U.S. sets the entrepreneurial benchmark. What’s more, the so-called Anglo-Saxon economic systems seem to engender more entrepreneurial activity than systems dominated by the social model, which is the prevalent system in most of continental Europe—and especially in France. The question remains: How do non-Anglo-Saxon economies find an entrepreneurial path that leads them out of the economic doldrums?

In this chapter, we have looked at the importance of entrepreneurship to national economies. In the following chapters we will look at the specifics of how entrepreneurs start and grow their new ventures.

We are excited that you are exploring an entrepreneurial journey, one that may lead you to launch a business while in college, after graduation, or at some future point in your life. We know that all great entrepreneurs are avid readers and thinkers, and as such we encourage you to capture some of your thoughts as you read this book. These thoughts may focus on a new venture that you are interested in creating, or they may focus more on your entrepreneurial career plan. In either event, we will close each chapter with space for you to reflect on what it means to you and your potential venture.

### Reflection Point

1. What world-changing industries or opportunities do you see developing over the next five to ten years?
2. What innovations or new technologies will drive these world-changing opportunities?
3. Which regions of the world have the greatest potential for developing these opportunities? Which are you most interested in?
4. What skills do you need to develop to take advantage of these opportunities?
WEB EXERCISE

What do you think will be the next major innovation (e.g., the Internet) that changes the way we work and play? Search the Web to identify trends, statistics, and other evidence to support your insight.

NOTES


2 Firms with fewer than 500 employees saw a net increase in employment of 1,150,875 over the period 2000–2001; however, large business employment decreased on net by 150,905. Overall net employment increased 999,970. The small business share varies from year to year and reflects economic trends. Over the decade of the 1990s, small business share of net job creation fluctuated between 60% and 80%. Small businesses accounting for all of the net new jobs is not unique to 2000–2001. During the economic downturn in the early 1990s, a similar result occurred. Sources: U.S. Bureau of the Census; advocacy-funded research by Joel Popkin and Company (Research Summary #213); Federal Procurement Data System; advocacy-funded research by CHI Research, Inc. (Research Summary #225); Bureau of Labor Statistics, Current Population Survey; U.S. Department of Commerce, International Trade Administration.

3 Schumpeter, J. A. The Theory of Economic Development. Cambridge, MA: Harvard University Press. 1934. (This book was originally published in German in 1911.)


6 For the Small Business Administration definitions of small business, refer to www.sba.gov/gopher/Financial-Assistance/Definites.txt.

7 This is based on GDPS and actual currency exchange rates in 2004.


11 Ibid. The estimate of new business startups ranges from 3 million to 4.5 million. It is impossible to make a precise upper limit because many new ventures are abandoned very soon after they are started and never get entered into any data set that tracks startups.


At one point General Motors was the largest corporation in the United States ever, in terms of its revenues as a percent of GDP. In 1953 Charles Erwin Wilson, then GM’s president, was named by President Eisenhower as secretary of defense. When he was asked, during the hearings before the Senate Armed Services Committee, if as secretary of defense he could make a decision adverse to the interests of General Motors, Wilson answered affirmatively but added that he could not conceive of such a situation, “because for years I thought what was good for the country was good for General Motors and vice versa.” Later this statement was often garbled when quoted, suggesting that Wilson had said simply, “What’s good for General Motors is good for the country.” At the time, GM was the one of the largest employers in the world—only Soviet state industries employed more people. http://en.wikipedia.org/wiki/Charles_Erwin_Wilson.

“The observation made in 1965 by Gordon Moore, co-founder of Intel, that the number of transistors per square inch on integrated circuits had doubled every year since the integrated circuit was invented. Moore predicted that this trend would continue for the foreseeable future. In subsequent years, the pace slowed down a bit, but density has doubled approximately every 18 months, and this is the current definition of Moore’s Law. Most experts, including Moore himself, expect Moore’s Law to hold for at least another two decades.” Source: www.webopedia.com/TERM/M/Moore%27sLaw.html.

Working independently and unaware of each other’s activity, Jack Kilby at Texas Instruments and Robert Noyce at Fairchild Semiconductor Corporation invented almost identical...

The first personal computers were actually called microcomputers. The phrase “personal computer” was common currency before 1981, and was used as early as 1972 to characterize Xerox PARC’s Alto. However, due to the success of the IBM PC, what had been a generic term came to mean specifically a microcomputer compatible with IBM’s specification. Source: http://en.wikipedia.org/wiki/Ibm5150.

The top 25 in descending order are the Internet, cell phone, personal computer, fiber optics, e-mail, commercialized GPS, portable computers, memory storage disks, consumer-level digital cameras, radio frequency ID tags, MEMS, DNA fingerprinting, air bags, ATMs, advanced batteries, hybrid cars, OLEDs, display panels, HDTV’s, space shuttles, nanotechnology, flash memory, voice mail, modern hearing aids, and short-range high-frequency radio. Source: www.cnn.com/2005/TECH/01/03/cnn25.top25.innovations/.
For example, a mid-1980s study by Calvin Kent of the content of popular principles of economics "revealed that entrepreneurship was either neglected, improperly presented, or only partially covered." Kent, C. A. and Rushing, F. W. Coverage of entrepreneurship in principles of economics textbooks: An update. *Journal of Economics Education*, Spring 1999, pp. 184–189.


Ralph Nader’s best-selling book *Unsafe at Any Speed: The Designed-In Dangers of the American Automobile* published in 1965 claimed that automobile manufacturers were ignoring safety features, like seat belts, and were reluctant to spend money on improving safety.


CHAPTER 1 The Power of Entrepreneurship

66 Singletary, M. How to get the most bang from eBay. Maine Sunday Telegram. August 7, 2005.


78 Excerpted from GEM global reports and special reports. www.gemconsortium.org.

79 Excerpted from the *Global Entrepreneurship Monitor 2004 Executive Report*.


81 Ibid.

82 Note: Education data were standardized across all countries in order to make this comparison possible.

Notes


95 *The Economist*, September 8, 2005.


99 Several studies have been done on the interests that young people have in entrepreneurship. For example, in their book *The E Generation: Prepared for the Entrepreneurial Economy*, Marilyn Kourilsky and William Walstad explain that youth are overwhelmingly interested in entrepreneurship. In fact, they found that six out of ten young people aspire to start a business of their own. The Gallup Organization, in conjunction with the Kauffman Foundation, conducted the first national poll on entrepreneurship. What they found was that 70% of students polled wanted to start their own business. www.entre-ed.org/testimony.htm.

90

<table>
<thead>
<tr>
<th>Rank</th>
<th>University</th>
<th>Country</th>
</tr>
</thead>
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<td>Harvard University</td>
<td>America</td>
</tr>
<tr>
<td>2</td>
<td>Stanford University</td>
<td>America</td>
</tr>
<tr>
<td>3</td>
<td>University of Cambridge</td>
<td>Britain</td>
</tr>
<tr>
<td>4</td>
<td>University of California (Los Angeles)</td>
<td>America</td>
</tr>
<tr>
<td>5</td>
<td>Massachusetts Institute of Technology</td>
<td>America</td>
</tr>
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<td>6</td>
<td>California Institute of Technology</td>
<td>America</td>
</tr>
<tr>
<td>7</td>
<td>Princeton University</td>
<td>America</td>
</tr>
<tr>
<td>8</td>
<td>University of Oxford</td>
<td>Britain</td>
</tr>
<tr>
<td>9</td>
<td>Columbia University</td>
<td>America</td>
</tr>
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<td>10</td>
<td>University of Chicago</td>
<td>America</td>
</tr>
<tr>
<td>11</td>
<td>Yale University</td>
<td>America</td>
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<td>16</td>
<td>University of Tokyo</td>
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<td>University of California (Los Angeles)</td>
<td>America</td>
</tr>
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<td>University of California (San Francisco)</td>
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<td>19</td>
<td>University of Wisconsin (Madison)</td>
<td>America</td>
</tr>
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<td>America</td>
</tr>
<tr>
<td></td>
<td>University of Washington (Seattle)</td>
<td>America</td>
</tr>
</tbody>
</table>

* Ranked by a mixture of indicators of academic and research performance, including Nobel prizes and articles in respected publications.

Source: Jiao Tong University, Shanghai.
CHAPTER 1 | The Power of Entrepreneurship

CASE

Malincho

Bulgarian Kalin Pentchev leaned into his cell phone conversation as he scribbled numbers on the top flap of a shipping box. Speaking quickly in his native tongue, the big man jabbed the air in front of him for emphasis.

"Look, I will tell you this. If you come down on your price, I will sign a contract to guarantee that my company will purchase one hundred thousand pounds of your cheese in the coming year."

He drew circles and blocks around the numbers as he listened to the impassioned response from a feta cheese producer 3,500 miles away.

"You need to think about that?" Kalin said at last with a fair amount of exasperation. "Well, don’t think too long; it’s already April and this year 2003 isn’t getting any younger. You’re not the only producer in Bulgaria, my friend, and you must understand that I will be signing a favorable volume agreement with someone, and soon. Right. Okay, you get back to me."

Kalin smiled as he clicked off. No matter that he had no idea how he could possibly sell that much cheese in a year, or that he was playing hardball with one of the only producers he felt he could trust back in his homeland. As was his nature, Kalin was moving forward like a tightrope walker performing daring feats without a net, protected only by a supreme faith in his own ability to overcome whatever challenge he encountered or set for himself.

As he resumed packing orders of East European food products to be shipped to his customers all over the United States, Kalin shook off concerns about the pile of neglected tasks back at his apartment; paperwork for a sizable UPS shipping credit, his U.S. tax return, and a few applications for debt-consolidation loans.

With his New Jersey–based import business, Malincho.com, growing exponentially during a slump in the economy, Kalin wasn’t going to let those pressing tasks slow him down. After all, to someone who had grown up under a communist regime, this business of capitalism in America seemed almost like child’s play.

Coming to America

In the spring of 1998, Kalin was awarded a small scholarship from Stockton College in New Jersey. Eager to get to the United States in advance of classes that would begin in September, Kalin joined a few friends who were headed for work with a summer camp in Maine. After discovering that his employer asked much and paid little, Kalin journeyed south:

I left the camp because I had some disagreements with the boss; they were paying way too low. . . . He treated us like we were white slave labor from Eastern Europe. I mean, we might be poor, but we are not slaves. . . . I went to Atlantic City where I had a friend in the university where I was going to study accounting. We lived in a community of about twenty people from Bulgaria. . . . So we found work pushing chairs on the boardwalk.

This case was prepared by Carl Hedberg under the direction of Professor William Bygrave.

© Copyright Babson College, 2003. Funding provided by the Ewing Marion Kauffman Foundation. All rights reserved.
Kalin graduated in 2001 with a degree in finance and accounting. Soon after, he appeared to have landed a job with a financial accounting firm. In a twist of fate, he instead found himself at a wedding in the Czech Republic, discussing the import/export business:

> A financial accounting firm almost hired me. They showed me the office, everything. They asked if I wanted to take the summer off before starting work like Americans usually do when they finish school. But I said, I need some money here now. I stopped sending resumes, because I considered myself hired. I don’t know what happened. I called them two weeks later to ask for advice on a place I could rest in their area, and they said, you know, we found somebody else. I said, why didn’t you call me? I mean it was ridiculous. I was very upset.

Right after this, I went to the Czech Republic. I have two cousins there and one was getting married. A dear friend of mine from Bulgaria had come over for this wedding, and on the day we would talk... We started talking about exporting damaged European-made cars from America back to Europe. So he said, when you go back to the United States find out how we can transport these cars...

Back in the States, it didn’t take Kalin long to learn that the high transport fees would make it nearly impossible to build a profitable damaged-auto export business. His research, however, led him to the idea of importing feta cheese and selling it to fellow Bulgarians on the East Coast—a growing, tight-knit community that he knew was hungry for a taste of home (see Exhibit 1.1).

Having decided to forgo looking for a job in favor of building an enterprise from scratch, Kalin held onto a part-time job he had all through school as a breakfast waiter at a popular Greek restaurant along the board walk. In July 2001, Kalin took the ferry to New York to meet with a former school classmate whose father owned a high-profile Bulgarian winery:

> They own one of the best wineries in Bulgaria and have been in the import-export business a long time. They sell wine all over the world and have offices in Switzerland and England. So this guy told me, “Look, I am exporting cheese now from Bulgaria to Switzerland. If you are thinking about the cheese we can go ahead and do it.”

He tells me it works like this. Everything is on the phone. You just call the producer and you order the cheese. You say this has to come here, this has to go there. You pay this guy this, you pay this guy that. You stay home and the phone. The container comes to you, somebody unloads it, and then you have to sell it. That’s it.

Then he says, you know, you will have to buy a whole container of cheese; not just one pallet, and a shipping container is like a whole room full of cheese. And so, I started thinking about the cheese.

### Research and the Wine Guy

Kalin already knew that the style of cheese known as “feta” was invented in the Trakia peninsula in southern Bulgaria. The Bulgarians called their version “white cheese,” while the Greeks created a mystique by using the word “feta.” Although the Greeks were now trying to legally prevent other countries from using the term feta, most cheese connoisseurs agreed that by any name, the Bulgarian product—especially that made from sheep’s milk—was the best in the world. Kalin learned that wholesalers sold the cheese...
## EXHIBIT 1.1 Bulgarian Immigration and U.S. Population

<table>
<thead>
<tr>
<th>Immigration Period</th>
<th>Reason for Travel</th>
<th>Estimated Numbers</th>
<th>Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>1920–WWII</td>
<td>Work as temporary field and construction workers</td>
<td>10,000</td>
<td>Most stayed and were assimilated into the U.S. culture.</td>
</tr>
<tr>
<td>Post WWII–1989</td>
<td>Asylum seekers escaping the communist regime</td>
<td>Minimal</td>
<td>During the Cold War, many qualified asylum candidates in the U.S. were regarded as potential spies.</td>
</tr>
<tr>
<td>Post-Communism</td>
<td>Tourism, education, work-visa lottery winners</td>
<td>The U.S. Bulgarian community is estimated at 300,000, with 60,000 in Chicago, 30,000 in New York, and 3,000 in the Boston area.</td>
<td>Ease of travel and established ethnic communities have diminished the need for temporary visitors to assimilate fully into the U.S. culture.</td>
</tr>
</tbody>
</table>

Data and analysis: Silvia Zaharinova, Babson College MBA ’03

The 2000 United States Census listed 55,489 U.S. citizens of Bulgarian heritage. The states with the large Bulgarian-American communities included:

- California - 7,845
- Illinois - 6,000
- New York - 5,937
- Florida - 3,310
- Ohio - 2,937

2000 Census Bulgarian-American population, by state:

- Alabama 217
- Alaska 106
- Arizona 1,052
- Arkansas 114
- California 7,845
- Colorado 1,495
- Connecticut 722
- DC 207
- Delaware 113
- Florida 3,310
- Georgia 967
- Hawaii 100
- Idaho 268
- Illinois 6,000
- Indiana 1,053
- Iowa 563
- Kansas 237
- Kentucky 226
- Louisiana 261
- Maine 221
- Maryland 1,160
- Massachusetts 1,140
- Michigan 2,522
- Minnesota 863
- Mississippi 87
- Missouri 804
- Montana 245
- Nebraska 161
- Nevada 1,014
- New Hampshire 118
- New Jersey 1,511
- New Mexico 228
- New York 5,937
- North Carolina 609
- North Dakota 142
- Ohio 2,937
- Oklahoma 429
- Oregon 904
- Pennsylvania 1,469
- Rhode Island 144
- South Carolina 363
- South Dakota 33
- Tennessee 317
- Texas 2,140
- Utah 434
- Vermont 52
- Virginia 1,168
- Washington 2,248
- West Virginia 203
- Wisconsin 766
- Wyoming 134
either vacuum-packed in various retail sizes, or as loose portions stacked between sheets of special paper inside sealed tin buckets of salty brine.

During the summer of 2001, Kalin spent a good deal of his time searching through the vast resources of the U.S. Customs Department—both online and at their ground-floor offices in the World Trade Center complex in New York City. A young customs clerk, intrigued with Kalin’s enthusiastic quest for information, saved Kalin time and money by offering her help in sorting through the myriad of import regulations, restrictions, and fees associated with food imports.

Kalin had always assumed that he would be importing an excellent grade of cow’s milk feta, since it was nearly as good as sheep’s feta—and less than half the price. The clerk, however, pointed out that the U.S. Government levied significant tariffs on imported dairy cow products as a way of protecting domestic producers. The best-quality sheep feta was duty-free, and would therefore be a cheaper import.

All the while, Kalin continued to brainstorm with his Bulgarian winery contact about developing a business where Kalin would receive, sell, and distribute containers of cheese that were funded and exported by this well-heeled and experienced professional. Since a minimum shipment of about 28,000 pounds of cheese would cost $40,000, Kalin figured that this arrangement would work well until he was able to save some money and gain more experience. After that, he imagined that he would make an offer to buy his partner out. He never got that chance. As the summer dragged on, Kalin began to suspect that this businessman was more style than substance:

I was doing my research about the cheese; how we can sell this cheese and so on and so forth. But it took this guy with the wine very much time to finish everything. He said he had a producer, he had the connections, so all we had to do was to agree on what to order and send. But he kept saying he was busy with other things, so at some point I got fed up. I said, “Look, we have to do something. Time is going.” The cheese business is seasonal since you can only milk the sheep from April to August. The rest of the year I don’t know. A short time later I was disappointed to find out that he was not actually exporting cheese to Switzerland like he had said. He was only helping a friend do it. He didn’t even know the price of the cheese.

As Kalin began to press his would-be partner hard for substantive action, he got a warning call from his trusted friend who had been investigating the auto-export opportunity. Bulgarian newspapers were reporting that the father of Kalin’s “wine guy” was not only millions of dollars in debt, he was also about to be indicated on charges relating to a host of questionable business practices. Kalin acted fast:

So I called the wine guy and said, “Look, why didn’t you tell me you are in deep trouble?” He said, “I have nothing to do with the winery. We have sixteen other firms that do different kinds of things.” He said they had a scheme where they can take the money out of the winery and put the cash in through other firms so they end up with the money in the end. He says they are fine, very fine. I mean no problem. So I said, you are what your father is, and I don’t buy any of this. And he said, oh, you doubt me? I am a big business man, and you are nobody.

With no savings and precious little knowledge of the import business, Kalin tried one last time to force the man into action:

I gave him three options. First, you can pay for the whole container since you are a big business man, and I’m going to sell that cheese here and we are still in business together. Second option was a fifty-fifty split where I would raise half the money. Or third, I would cover his expenses up to that point.
I told him that all this money, this forty-thousand dollars, I have to raise from somewhere. I don’t have it in my pocket. I just graduated school and I’m in debt already.

He said, “Look, I am going to give you a chance. You pay for the first container as a test. If you can sell this container, this means that you are a good businessman. Anyway, for a second container you’re going to need the same amount of money because you have to overlap the containers. By January, if you sell everything I’m going to join in with the big money. Okay?”

Not okay. Kalin hung up on him and began calling everyone he knew.

The First Container

Kalin had been talking to people in his community about his import business for some time, so many of the calls he made were to friends who had expressed interest and encouragement. He explained that he needed to raise $40,000 in cash, since, as many of his Bulgarian compatriots already understood, credit cards and bank drafts would not be accepted. Cash meant cash. Kalin described his pitch to raise money.

All my friends were students, working hard—some working two jobs. They have money in the bank, but it is for tuition. I told them, look guys, together me and my girlfriend have over forty-thousand dollars as a line available on our credit cards. What we are going to do if this thing screws up is take cash from those cards—never mind about the big interest that they will charge us—and at least we are going to pay your tuitions with those credit cards. I mean, I never lied to anybody that I have money on the side, or that my father is rich or something.

In one hour Kalin had exhausted his contacts and had raised six individual investments of $5,000 each—all interest free. Still, he was $10,000 shy of the cash he would need to order a shipment of cheese. Then he had an idea:

I called up a friend of my family in Bulgaria. Tania was a businesswoman for real. She operated one of the best restaurants in the second biggest city, and she was like an aunt to me. She said, “Okay, I am going to put ten grand into this.” Now, I knew that I couldn’t send all this money to the producer because I didn’t know the producer. So I told Tania that all money goes through you, you pay him and make sure you see the things loaded on the container. She said fine.

On the fifteenth of August, my friends gave me the money—five days later I sent thirty-thousand dollars to Tania in Bulgaria. So she paid the guy; one third when we placed the order, one third when they began packaging our order, and the last third when they loaded it into the container. After the producer has his money, he forgets about you right away.

Lose Your Job? Buy a New Car

On the last morning of August, Kalin reported for his waitstaff job at the restaurant as usual, but discovered that he had been taken off the schedule. Earlier that summer, Kalin had mentioned his business idea to the owner of the establishment (a wealthy Greek gentleman who at the time was the largest landowner in Atlantic City) in the hope that the
businessman might offer some helpful advice. He didn’t, and when he learned that Kalin had gone ahead with ordering the cheese, he had him terminated because he was afraid that Kalin would become distracted and unreliable. Kalin recalled that his initial anger at this latest curveball was almost immediately overtaken by a desire to hit a homerun:

I had been working there nearly four years; I brought them so many Bulgarian customers and workers! I got so upset I wrote the Greek guy a letter. I said that he should have at least warned me. So he called me, and says that his aunt is running the place, and she had a bad moment and decided to take me off the schedule. He said it was okay; that I could come back. I said forget about it.

Then I said to myself, “Lunch, probably this is good, because I will never stop working at the restaurant because it is cash on the side.” I was going to be importing-exporting, so I had to forget about that job as a waiter.

My car had just broken down, and my girlfriend and I were fed up with buying old cars that get broken all the time—with dealers and mechanics always screwing you and never fixing in right. Also, when you run a business, you have to have a decent car. So on the fourth of September we ended up buying a brand new Maxima—the perfect car. My container is at sea, and I buy a brand-new car.

Having virtually no cash on hand, Kalin put the $3,000 down payment for the Maxima on his credit card. With no further payments due for 45 days, Kalin was determined to make the most of this grace period. His first journey in the new car was to a large refrigerated warehouse 30 miles away in North Jersey, since he understood that he would need an established storage facility to accept delivery of his cheese after it cleared customs. Knowing also that these businesses typically would not work with startups or inexperienced clients, he wore a suit and tie. Dressing for success might have had some impact, but, he recalled, it was his new set of wheels that really made the difference:

My car helped me to get the storage, because the owner, Tony, was from a rural area and he judged people by their cars. So I come there with a brand-new car. I am young—his age—and I had a better car than he did. He had some truck, and his sister—who owned the storage place with him—was driving a Nissan Sentra. And I drive up in a Maxima with almost no miles on it.

So I told him that I had started doing the cheese, and that it was a good business. He showed me the storage, and we started talking about the cheese. He was thinking we are big; he didn’t know it was only me. Then he said, look you’re not dealing drugs, right? I said, come on now, I am not dealing drugs. He was thinking I am Russian.

Kalin contracted with a customs broker whose job it was to expedite the paperwork and procedures necessary for the cheese to clear customs. She explained to Kalin that since this was a first-time import, the container would likely be thoroughly checked before it was released. As nervous as an expectant father, Kalin made it clear to her that he wanted to be notified the moment the container passed customs so that he could be at the storage facility when it arrived. Then, on September 11, 2001, while Kalin’s container of cheese was at sea, Kalin’s container of cheese

In 2002, the Narcotics and Organized Crime Bureau division of the New Jersey State Police indicated that political, economic, and social changes occurring in the former Soviet Union and Eastern Bloc countries had provided significant opportunities for Russian organized crime groups to expand their influence in and around the state. In April of that year, federal authorities announced a sweeping racketeering indictment against ten suspected Russian ‘émigré mobsters operating in Philadelphia and in Northern New Jersey. Sources: The New Jersey State Police, the U. S. Department of Justice, and The Philadelphia Inquirer (Charges reveal new-look mob of Russian émigré, April 26, 2002).
was still somewhere out in the middle of the Atlantic Ocean, terrorists flew a pair of passenger planes into the World Trade Center buildings in New York City.

Welcome to the Business

In the confusion following the attacks, Kalin’s broker had been able to get his container released without delay. The bad news was that she never called to give Kalin the good news. On September 25th, Kalin got a heart-stopping call from Tony, the owner of the storage business. The container had been delivered to his facility, but when he opened it (to check for drugs), he discovered a smelly mess of leaking buckets of cheese. Kalin jumped in his Maxima for the long, nerve-racking drive. What he found when he got there was not good:

The producer [in Bulgaria] had packed eighty square metal buckets—they weigh forty-four pounds apiece—one over another in eight rows. Now they are not using perfect metal because they want to keep the packaging cheap—and the salt kills the metal. You can imagine the bottom two rows; these big cans were cracked, and the white salty brine was all over the floor. It smelled, and Tony wanted to know what I was going to do about it. And I was thinking, oh my god, what am I going to do now?

Kalin rolled up his sleeves and went to work. Hours later he was relieved to find that less than 5% of the order had been damaged in transit. Once this tally—just under 1,000 pounds—was confirmed, Tony directed his workers to help Kalin toss the broken containers into the dumpster. Kalin took Tony aside:

I asked him to allow me to repack this cheese. There was a lot of money there, and also, I was brought up that you can’t throw away food. I told him that when I was young, I used to starve, and my father used to starve. You always ate everything on your plate. As an American person, Tony was thinking that because the insurance will pay, why bother repacking, just throw it out because you will get the money anyway. I was thinking that since it was insured in Bulgaria, there is no guarantee that I am going to get this two-thousand dollars. So I told him I can’t throw the food away. I cannot afford to do that.

Despite a state law prohibiting nonemployees from entering a transfer-warehouse facility, Kalin prevailed. He rushed home to recruit some friends to help him out, and to give the producer in Bulgaria a call:

I called up the producer and said, how did you load this? I pay you for cheese that is supposed to be in a package good for sale, not for repack. Also, out of six different kinds of cheese just one of them was matching the invoice number. Most of them were less, some of them were more. This is ridiculous. I said, come on! I paid you everything; you send me less, and then we have damage because you arranged the cans like this. All he said was, “Welcome to the business.” Can you imagine this? But he did give me the recipe for brine—water, salt and lemon extract. With two friends helping, it took us a week to repack those broken cans piece by piece.

On the Road

Now that he had his inventory organized and secure, Kalin began to sell the quality cheese locally at very low prices. A short while later, he received some important advice from a Bulgarian feta producer:
I was doing anything to sell, because I had to sell the cheese, but this guy from Bulgaria reminded me that the milking season was over for the year. He said that to be in this business, you have to sell the cheese slower, and at a higher price. If I sell at 5% margins, he said that you are going to end up getting no more merchandise from us.

So I said okay. I make a brochure, I rent a truck, and I went down to a Bulgarian church in [Washington] D.C. where people were gathering together. A lot of friends were helping me because they spread the word to the community, and I was delivering the cheese to people’s houses with the truck—no matter the gas.

Realizing that Bulgarian feta was prized throughout the Middle East and Eastern Europe, Kalin cruised the ethnic neighborhoods around D.C. in search of restaurants, delis, and grocery stores. Since his mobile method of distribution and sales seemed to iritate a type of street-side haggling common in open-air marketplaces around the world, Kalin found himself struggling to maintain his pricing structure. At one stop, a Lebanese storekeeper drove a particularly hard bargain for a sizable bulk order. After Kalin had unloaded and packed the order neatly in the shop’s cooler, he found the man wasn’t finished haggling:

He looks in his drawer, and he says, “You know, this price too much, I’m going to give you less, because you never called me, you never sent me samples, you never did anything. So come on, come on, I’m going to be buying only from you from now on.” I got back in my truck after and I said I have to be out of my mind. I mean, if for the rest of my life I’m going to deal with people like this, I’m going to go mad.

Worse than the constant haggling was the realization that while these retailer were selling his product for at least double their cost, Kalin sensed that the truck rental alone would eat up most of the 20% margins he was struggling to uphold. for all his hard work, he suddenly feared that he might even end up with less money than what he had started out with.

Desperate and determined, he started calling large-volume cheese buyers along the East Coast—intent on pre-selling some orders before he set out again. Kalin explained that it was in late October of 2001 when he had a major breakthrough:

So, I call this one big company in Florida—I think they were importing from Greece—but the guy wanted to see the cheese. He asked me to UPS him one small round can. Oh my gosh, I thought. I immediately called a friend and told him that I sold all of my cheese. He said, really? You sold the cheese? I said no, but if I can send samples on the ground with UPS, then I knew that I am going to sell everything I have—through the mail and online.

Kalin moved quickly. After UPS and Federal Express both assured him that they had no restrictions against shipping cheese products, he established a Web site named Malincho—a playful Bulgarian nickname for a little boy. Then he set about to find a source of economical shipping containers:

I didn’t want to spend money on boxes, so I go to all my friends to see if they had recently bought a TV, a microwave, or had other boxes around. My first two orders I sent to a friend who works in a pizza place in Boston . . . I just put the can in the box—no cushion; nothing else. I figure this can is very tough so I’ll just put the label on the box. I just dropped it at UPS, and it was perfect. My friend called and said she can get here—with no damage, thank you very much.

Three weeks after Kalin mailed out that first package, a UPS representative paid a visit to the world headquarters of Malincho.com—the small apartment Kalin shared with
his girlfriend and two other friends. Kalin explained to the young salesman that every few
days he would fill up the Maxima at the cold storage facility, and then store and ship the
product on the back porch because it stayed cold out there. The rep—who had been sent
there to open a business account with Malincho before their competitor FedEx moved
in—seemed surprised and a bit amused by the meager surroundings. Confident that he
would be wiping that smile off the lad’s face soon enough, Kalin served up strong coffee
and laughed right along with him.

Credit Sales

By November, Kalin was driving customers to Malincho.com by word-of-mouth and
with small advertisements in Bulgarian newspapers. He set up the site to accept major
credit cards, but discovered that many of his fellow countrymen were reluctant to place
orders online:

The holidays were coming, and people were visiting online. But many of these Bulgarians
had won the “green card lottery” and they came here not knowing English or anything
about America. In Bulgaria there is a lot of credit-card fraud, and people had heard that
some of the criminals were using Web sites to get credit-card numbers. And they think
that my site smells like I’m going to get their credit card and start charging for this and
that. And if that happens, they think, “how am I going to dispute the charges if I can’t
even speak English?” So then, they don’t buy.

To overcome this obstacle, Kalin decided for a time to build his business on trust.
Customers would receive a Malincho invoice with their delivered order, along with a note
requesting prompt payment for the cheese plus shipping charges. Kalin carefully tracked
his receivables and found that if it had not been for one woman in Ohio and a shopkeeper
in New Hampshire, his bad debt account would have been zero. Many of his friends were
shocked to learn that he was shipping orders, some of which totaled hundreds of dollars,
on faith. Kalin was not as surprised, though, since Malincho.com was fast becoming
an online community of people who literally spoke the same language; and back home,
stiffing a vendor was a serious offense:

My buyers were thinking; here is this Bulgarian guy importing cheese. He should be big, or
if he’s not big, he has somebody powerful behind him. And if I don’t pay him, he can get to
my relatives in Bulgaria and beat them up for the money.

So I figure, why pay over 2% to Visa or MasterCard when with this cash payment
method customers appeared to be coming, and paying? And besides, it was helping me
build the business.

Expansion

The early part of 2002 was a very busy time for Kalin, who was doing deals all over the
board. In January he purchased several pallets of Lutenica, a Bulgarian condiment, from
a woman in D.C. who had given up trying to sell off a container that she had imported
a couple of years earlier. Kalin added the spread product to Malincho.com at a high
markup, and when it sold very well, he rolled his cash on hand into a container of 20
pallets of other assorted dry-storage items like marmalade, roasted red peppers, and thin wafers. With the help of a $5,000 sale from Florida and a similar sale to an import group in Chicago, by April, Kalin had nearly sold out his inventory of cheese.

As the weather warmed up, the Maxima—splattered throughout with cheese and brine—began to reek. Not wanting to degrade the car any further, and needing a larger transport vehicle anyway, Kalin took out his credit card once again to purchase a Chevy van.

The changing season also meant that the back porch of his apartment would no longer work as a refrigerated shipping area, but Kalin had not been able to convince Tony to rent Malincho refrigerated repacking space. After Kalin had placed an order for a third container—all cheese, like the first—he approached an established importer who was leasing a cold-room from Tony:

> This one French guy was renting one of the rooms but it was too big for him. So I suggested to the French guy that we split the room—and I would pay Tony extra money. I told him I didn’t need much space, just enough so I can pack and ship. But Tony got very offended because to him it looked like I was trying to work out a side deal with the French guy. I said no, no, I am willing to pay you extra to do this so I can get my business going. He refused, and then he said, it’s time for you to find another storage place.

Out on the street with another 28,000 pounds of cheese chugging toward New York, Kalin went to see a Russian sausage maker in his neighborhood that he had heard had more refrigeration and dry-space than he was using. They came to an arrangement that Kalin explained was far from ideal:

> The Russian guy said, okay, you can use my place here for six-hundred a month—cash under the table—off the books. But that’s it — no key, because, he said, look, I make sausages here; you can come here only when I am here. That’s it, end of story. He doesn’t know me, and I don’t know him, and now I am going to put my product inside his place. I was thinking that once I get all my cheese in there, he could lock the door and say get off my property—I don’t want to see you. Sometimes, though, you have no choice—you just have to make decisions on trust.

Even with the shipping department moved off the back porch, the steadily increasing sales had begun to strain life in the small apartment. Kalin and his girlfriend soon moved to an apartment of their own—complete with enough space to run the business side of Malincho.

In advance of the summer months, Kalin set out to devise an insulated shipping container. After much research and running around, Kalin purchased a bulk order of boxes and pre-cut styrofoam inserts. Realizing that the sausage maker would never agree to accept numerous pallets of packaging materials, Kalin convinced the box seller to inventory the supplies. Kalin was pleasantly surprised to discover that once he switched from used appliance boxes to insulated containers with ice parks, sales spiked by more than enough to cover the added shipping costs.

By the fall of 2002, Kalin had negotiated volume-customer pricing with UPS and with his corrugated box supplier. He had also convinced his Bulgarian suppliers to properly shrink-wrap all of his orders onto pallets that conformed to U.S. standards for size and construction. Most importantly, those suppliers had agreed to help Kalin control his inventory flow by shipping mixed orders containing a variety of different products.

A reporter from USA Today called in the middle of the busy Christmas season. Kalin was at the sausage plant, and Vladimir—Malincho’s self-taught (and volunteer) Webmaster who had studied accounting with Kalin back in Bulgaria—answered the
phone in his native tongue. The reporter didn’t call back, but he did visit Malincho.com (see Exhibit 1.2). Kalin recalled the thrill of having his young enterprise mentioned in the national press:

People called me from Bulgaria because one newspaper in Bulgaria literally translates everything from USA Today. I couldn’t imagine that we had been in business for just one year and a half and here we are being written up in that newspaper, Newsweek magazine did an article and quoted me, and then there was another article in a Bulgarian newspaper called Capital—that reporter didn’t even call. He found us online. It was amazing.
Funding Challenges

Bolstered by press coverage and the strategic use of search-engine tags, Malincho continued to add customers to its core base of about 2,000 loyal regulars. Since many of those customers still were not willing or able to shop online, Kalin produced a simple inventory printout that was sent with each order. By February of 2003, Kalin had his own key to the factory, and online sales of his landlord’s sausages—listed under “Meat Products” on Malincho.com—were more than covering the rent for the shared space. Sales were averaging $16,000 a month, inventory on hand was just under $60,000, and the fifth and sixth containers were on their way. Kalin was packing and shipping more than 100 orders per week to customers who were now required to prepay by check or credit card.

All of this activity had ballooned his need for short-term capital, and although Kalin had paid back half of the people who had extended him funding for the first container, he had found it necessary to borrow more cash in order to keep his inventory current. Kalin summarized his financial situation:

Right now I owe about forty-thousand to credit cards, and sixty-thousand to people. I also have a ten grand personal loan from Fleet Bank. A while back I went to them and said that I wanted to consolidate the debt on my credit cards. When they gave me money, I put it into the business. Now I want to consolidate for real this time, but the banks say I need three years’ tax returns—I haven’t been here that long. I figure I need about one-hundred grand to consolidate my debts, and another fifty-thousand dollars so that I can get my own place for storage and packing. Then I could hire people to work for me so we could grow faster.

Kalin was in that enviable yet difficult point on the new venture curve where his growing business was too small to financially support even one full-time employee, but was large enough to require his every waking hour. He described a typical day:

In the morning I’m taking orders, making labels, calling people, and playing big businessman. In the afternoon I am just a worker who has to check the orders and pack all the packages. It’s not easy, but it’s worth it. Physical labor is healthy labor. I am not ashamed of doing anything because it’s what you have to do to grow.

Not Going to Go Down

Kalin sealed up and labeled the last box for that day. Grabbing a chocolate-coated Mura wafer bar from inventory, he hopped up onto a pallet of Lutenica for a short break before heading home. Long days. Precarious finances. It was time to make some decisions as to how best to move forward.

Although Malincho.com had become his main source of sales, Kalin was weighing other options as well. Retail margins, for example, were so much higher than wholesale that he was considering opening a storefront location. Wholesaling, on the other hand, was a no-frills business model that worked well with Kalin’s need to meet with a variety of key wholesalers, retailers, and suppliers. Although Kalin knew that getting better control over his finances was critical to the survival of his growing venture, he had discovered that it takes more than money to grow a business:
I know that a small business can go down for three reasons. First, if you give up, that’s it. You have to refuse to give up. The second big reason is the money. If you don’t have the cash flow to pay your bills, you die. But the most important thing is you. Because if you believe in something, and you can find other people who believe in the same thing, you’re going to be able to do it, no matter what.

Preparation Questions

1. Apply the Timmons entrepreneurship framework (entrepreneur-opportunity-resources) to analyze this case. Pay particular attention to Kalin’s traits and how he gathered resources for his venture.
2. What business models are open to a food-product importer? What steps should Kalin take to position his company for the next phase of early-stage growth?
3. Imagine you are a potential investor and Kalin has just given you his rocket pitch. What are your concerns? Would you help him out?