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focus

Entrepreneurship

Entrepreneurship is one of the greatest drivers of humankind. Small business has long been known as a key source of new jobs and economic growth, but entrepreneurship is a critical success factor for all businesses. As a business school devoted to developing principled leaders of industry, we are compelled to study and facilitate entrepreneurship. While Baylor Business' reputation for leadership in the study of entrepreneurship has been long established, we thought you'd enjoy this *Focus* on the more recent research of our leading entrepreneurship faculty.

Research can't find entrepreneurial gene

Envision the bold entrepreneur, striding into his penthouse office to make decisions that create palpitations in the faint of heart. He is Hercules in a natty suit. His decisions may rocket the corporation into the next stratum or bring it to thudding demise. He flies by the seat of his pants and prefers that to first-class. He loves the uncertainty.

Although some of those images about the decision-making processes of a business builder might be true, Jeff McMullen shakes his head at the idea that entrepreneurial behavior is the exclusive domain of rugged individualists. McMullen, who studies entrepreneurial decision-making, prefers to focus upon the situational characteristics people find themselves in rather than some defining personality trait as the predictor of such behavior. Despite a seemingly exhaustive search, researchers have not found the entrepreneurial gene, he said. Life is too complex.


Jeff McMullen

"We choose goals that demand a certain type of thinking," he said. "You may be passionate about an idea and realize that creating something new is going to be risky, but that doesn't mean you enjoy risk for its own sake." Pointing to research that suggest that most entrepreneurs don't consider themselves gamblers, McMullen argues that risk, like beauty, is often in the eye of the beholder. "What you or I perceive as incredibly risky may look like a sure bet to someone who is knowledgeable, experienced, and passionate about an idea. For her, continuing in the same dead-end job with no promise of personal fulfillment may seem far more costly than taking a reasonable chance on bringing a dream to life."

The assistant professor of management at Baylor University found opportunities to study the subject of entrepreneurial decision making after getting his bachelor of accountancy at New Mexico State University. Before pursuing his master's and Ph.D. degrees at the Leeds School of Business at the University of Colorado at Boulder, he audited numerous companies for KPMG, Denver's Information, Communications and Entertainment division. His clients ranged from mom-and-pop shops to new ventures.

"I loved that. I liked high-growth firms, people trying to turn (the firm) into something big. They were excited about what they were doing, and it was fun to work with them."

This period of his life helped lead him to his current research on decision-making and to a paper titled "Uncertainty in the Theory of the Entrepreneur," which is due to be published by the *Academy of Management Review*. It's also led him to research on the subject of opportunity recognition, or how people go about recognizing entrepreneurial opportunities.

Although lots of methods exist, one way is for people to identify needs in their communities, match them up with personal talents and passions, and ask themselves whether they can fill the need profitably. In other words, entrepreneurs think win-win and strive to come up with ways to benefit themselves by benefiting those around them. "It's not altruism, but it is a close cousin," added McMullen. "Entrepreneurship begins with giving of one's time, energy, and resources in the hope that enough value will be created to satisfy customers while leaving enough to make the endeavor worth the entrepreneur's while."

His working title for this theory is "Murder, She Wrote," with a tweak. Where that television series identified murderers with a means, motive and opportunity, his theory deals with a motive (passion, money, influence, etc);

See **Discover the Answer** *continued on page 2*

Discover the Answer *continued from page 1*

the means to do the job (know-how and other resources); and the opportunity (needs in the communities of which the entrepreneur is a part). But where do these opportunities lie? To discover the answer, entrepreneurs must look to their situation or environment.

"I can't predict anything unless I know the context in which you live," said McMullen. "Take a great writer, for example. If Steinbeck had not been from California, would he have written *The Grapes of Wrath*? He would have been a great writer anywhere, but he drew heavily from the opportunities provided by his environment."

He sees the pattern everywhere — in programs his 5-year-old watches on television, and even in the Bible, where Jesus tells the rich man he must give away his means to get into heaven. Although some people interpret this to mean Jesus dislikes wealth, McMullen disagrees. "I don't think Jesus has a problem with wealth, per se, but rather with what wealth does to a person — it can insulate you from realizing your dependency on God," he said. Wealth weakened the ruler's dependence on, and need of, God (motive) and as a result prevented him from seeing the opportunity of grace that Jesus presented.

The lesson for the entrepreneur searching for opportunity is that he must evolve and not forget his dependency on both current and future customers. "If things are going really well, it's hard to continue looking for the next opportunity, but he mustn't get complacent." This means he must keep asking himself what the needs are around him.

For the Baylor professor, finding one area to focus on has been a struggle. He has a passion for both history and literature, and knew auditing wasn't the path he would follow. "It was taxing," he said. "People would dread you coming. You go in on a Monday and you'd even hear them say, 'The auditor is coming.' By Friday you've won them over. But it would start all over again next week."

He got some job offers that almost lured him from his graduate school path, one in particular with a company that was about to go through the roof. "I chose to go to school, and that was really tough," he said. He watched the company's fortunes grow, then shrink, all in the space of a few years. It was proof to McMullen that following your heart can work out right. He followed it into theory and research, where he can look creatively at new ideas and frameworks and try to explain how entrepreneurs and business work.

Seeing the right path has not always been easy. "It's tough for a fox to become a hedgehog," he said, referring to the theory in Isaiah Berlin's essay on Tolstoy, "The Hedgehog and the Fox." (The fox knows many things, but the hedgehog knows one big thing.)

Jim Collins expanded on the fox-hedgehog essay in his book, *Good to Great*, in which he examines merely good companies as well as great ones. The good ones are foxes, Collins said, organizations that try new tricks and get short-term results. The great ones are the hedgehog organizations that discover good execution of what they do well is the key to greatness.

Scholars often face the dilemma of being foxes instead of hedgehogs, said McMullen. Still, his own experiences help him counsel students who worry they are on the wrong path, believe there is only one path to success, and fear that they won't find it. "The key is to go out and try stuff, and discover what is it you like and don't like."

When businesses develop new businesses

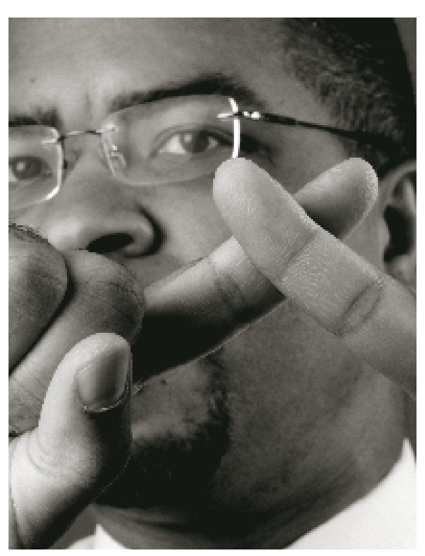
Before one tries to define what internal corporate ventures are, it's important to note what they are not.

Although internal corporate ventures involve people and entrepreneurship, they are not the same things as individuals starting a business. And although they might involve new products and processes, they are not the same as new product development.

The distinctions are key to getting the right answers about what makes an internal corporate venture work, said Kevin Johnson, a new professor at Baylor's Hankamer School of Business. His research reveals fresh information about corporations starting new businesses, and why they fail. He's looking for answers that will help them succeed.

The former engineer turned businessman turned professor is just beginning his work in the broad area of corporate entrepreneurship. The themes he's focusing on include internal corporate venturing, new venture creation strategies and business and technology innovation.

The distinction between individual and corporate entrepreneurship is an important one because of the dynamics that take place, said Johnson — "not the least of which are the resources available," he said. The individual entrepreneur generally has more limited resources than the established corporation.



Kevin Johnson

It's important to separate product development from the study, too. Although developing new products within an existing corporation might overlap with internal corporate ventures, new product development doesn't require the establishment of a new organization, noted Johnson, and is not intended to. A new corporate venture is one that becomes a new business, he said, using the example of a refrigerator manufacturer taking his product into the recreational vehicle market. "Adding new features is not a new business," said Johnson. "That's product extension or modification. When the refrigerator was taken into the recreational vehicle market, that represented a new business. Think of a hospital starting a business to provide fitness training. It can be a new business for them."

A new venture can be based on a product, market, technology, service, or a process, he noted. And research into internal corporate ventures is important because they represent economic growth and development for corporations and the communities they serve. Further, corporations invest billions in new businesses to remain innovative, competitive and avoid stagnation.

Even so, the majority of new ventures fail. "We're not talking about 50-50," he said. "We're talking about 90 percent." Depending on how one defines failure, the rate can sometimes drop to 50 percent. "Fifty percent is still no better than chance, and we want something better than that."

His goal is to find out what drives success for new corporate ventures, and one important discovery shows that the skills that go into successfully running a business are not the same skills that go into starting a business. "Established managers think they can start up a new corporate venture," Johnson said. "But the same skills don't work."

Experienced managers also might think they can successfully create a startup venture because they are doing product development. "It's not quite the same," Johnson noted.

Johnson has developed and tested a new model based on performance. Some of his findings are in the areas of processes, resources, strategy and structure. Here's how some of those have played out thus far:

Similarity

Johnson defines similarity in terms of product, technologies and markets, and looks at how the new venture is related to what a corporation is already doing. New ventures differ somewhat from a corporation's existing businesses, but most research indicates similarity is important. Johnson is testing that assumption.

Resources

His preliminary research, gleaned from surveys and interviews, shows that lots of money is not the answer, but having the right people in place may play an important role. "Organizations are actually starting to train people to be entrepreneurs within a company," he added.

Putting more financial resources into a new corporate venture may lead to complacency, he noted. "You don't have the desire, the motivation, the urgency if you have tons of resources available to you. The independent entrepreneur has that urgency. It focuses their efforts."

Other areas Johnson examined include autonomy, strategy, and positioning. He asked such questions as, "When you have a business startup, how do people working on that startup get compensated? There could be conflict between startup and existing businesses within a company. There's a struggle for resources. How do you organize the venture around existing businesses? Is it linked structurally with them, or is it located somewhere else?"

His current research also studies whether managers of a venture need to go into it with a plan.

"Preliminary examination shows that it looks planned," Johnson said. "That suggests to me that managers need to have a goal in mind — what they're going to do and how to do it. What I suspect is going on is that the strategy could actually be changing as the venture is developing."

The X-factor

Corporations of course believe their ventures will add value to their company, Johnson noted. "When I ask my respondents about what I call the X-factor, I ask how clear were the venture managers in terms of this X-factor. It was important that the organization understood this X-factor."

Although this is last on his list, it might turn into one of Johnson's more important discoveries. Also important is the similarity between that venture and the parent company, "because it affects our understanding of the market or the products or technologies. Also, because it is a new business, what is its X-factor? These two tie together."

Johnson believes some of his findings may challenge prior research, which would suggest that the landscape has changed. "What worked in the past may not work today," he added.

The Kentucky native received his bachelor's degree in engineering science from Dartmouth and worked for several years before getting his master's in business administration and his Ph.D. at Indiana University. Although he enjoyed business, he knew he'd have to move to different areas of interest if he wanted to climb the corporate ladder and make a difference. "So I had to decide whether to stay in business and move on to other things, or go into academia," he said. He got involved in corporate entrepreneurship in the academic world because he found it exciting and it was related to what he was doing in the business world.

Self-employment comes with own set of surprises

James A. Roberts

The results James A. Roberts finds a bit surprising when he looks at his research on the satisfaction levels of the self-employed is not that they find fulfillment in their new roles, but that their levels of job satisfaction register only a fraction higher than those who work for an organization.

However, The W.A. Mays Professor of Entrepreneurship at Baylor University believes he's found at least a partial answer to why the pleasure over being one's own boss doesn't always reach Richter scale levels — as much as conventional wisdom suggests that it might. People who go into business for themselves may not have realized beforehand they'd be wearing so many hats at work — that of buyer, accountant and computer guru, for example.

"We found that entrepreneurs are more satisfied, but maybe not as much as folklore would suggest," said Roberts of research he conducted with former Baylor sociology professor Don Bradley. "(Self-employment) may be a good solution and certainly plays a vital role in our economy. But it's not a bed of roses."

Roberts, associate professor of marketing, has written two papers with Bradley on this subject of becoming one's own boss. The first comes from the National Survey of Families and Households, and the second from the British Household Panel Survey. His current research interests include sales force change management, consumer behavior, and studies at the entrepreneurship-marketing interface.

"I do a lot of research in the area of consumer behavior," said Roberts, who examines subjects like materialism, compulsive buying and credit card use. His study of job satisfaction and entrepreneurship came as he was searching for important issues to research. He considers the issue of job satisfaction and entrepreneurship important because entrepreneurs provide growth and creativity in the economy.

The reasons entrepreneurs strike out on their own are no secret. They turn to self-employment because it holds out a chance for greater money, more freedom and responsibility, and more happiness with the daily task. But Roberts found the reasons for entering self-employment are often a double-edged sword.

In his first examination, which looks at the reasons why people become self-employed, he approached the question of self-employment using the "push-pull" taxonomy that argues there are two main avenues to self-employment.

"One is that they are pushed into it by mergers, downsizing, terminations and multiple relocations. People say, 'I've had enough.' " These people feel pushed into going into business for themselves, said Roberts.

Others enter self-employment because they believe they would be happier if they worked for themselves. "We all want to use our creative abilities and have the autonomy to make decisions," he said. "This is the pull side. A lot of us are pulled into it because of those reasons. It's bundled into job satisfaction."

But truth exists on both edges of the sword, said Roberts. "The lure of entrepreneurship or self-employment is very strong in America. People want to be their own boss. Also, the chance for greater financial remuneration is very important. But I think people go into it for the lifestyle — the autonomy and responsibility that come with self-employment. The idea of job satisfaction. They enter because they figure they would be happier."

The first study that Roberts and Bradley conducted talks about this "pull" side of self-employment. "We do find that people who are self-employed report higher levels of job satisfaction than those who work for an organization. But it's not as big a difference as you might think. It's half a point or four-tenths of a point on a five-point scale — 3.5 or 3.9. But it is hundreds of thousands of people. So we found that yes, the self-employed are more satisfied with their jobs. It gives some credence to the idea that they are lured — pulled."

He also found something else interesting in the first study: "Although we found that the self-employed reported higher levels of job satisfaction than the organizationally employed, it might be self-selection. The self-employed are self-efficacious. Self-efficacy means a high level of confidence in your ability to get the job done. They are more likely to be satisfied with their jobs as entrepreneurs." They are also less prone to depression, he added.

Roberts and Bradley discovered that self-efficacy, or high confidence in your ability to get the job done, is a particularly important trait for entrepreneurs. "A person's sense of self-reliance that he can get things done is very important in his decision," he said.

In a second study, the two professors looked at self-employment from the opposite side: the perspective of people who are pushed into starting their own businesses. "The second study showed that people less satisfied with their organizational jobs are more likely to become entrepreneurs," said Roberts.

Another thing they discovered in the second study is that the longer a person has been self-employed, the more he realizes how dissatisfied he was with organizational employment. "As you find success, you do realize a greater level of self satisfaction," he said.

One factor that interests Roberts is that being dissatisfied with a job helps people already prone to entrepreneurship to take that final step. "In a way, I am surprised that it's such a big decision. They may have been on their third or fourth job before they realized what they want is not going to be found in an organizational setting."

He and Bradley, who attended the same church when Bradley lived in Waco, discovered they had research interests in common. "My research has a psychological bent, so we had crossover interests," said Roberts. Although Bradley is now at East Carolina University in Greenville, N.C., they are continuing their research with a third study that looks at different facets of organizational job satisfaction such as autonomy, pay, and responsibility. They want to discover which of these factors are the most important in the decision to seek self-employment.

"We have a number of projects in the works," added Roberts. "Don is looking at immigrant self-employment, studying different cultural groups and what makes them more or less successful, what factors help them and encourage them."

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Dean, T.J. & McMullen, J.S. "Toward a Theory of Sustainable Entrepreneurship: Reducing Environmental Degradation through Entrepreneurial Action." *Journal of Business Venturing*.

McMullen, J.S. "Escalation of Commitment in the Mount Everest Disaster: Implications for the Entrepreneurial Mindset." Under review.

Shepherd, D.A. & McMullen, J.S. "The Lesser of Two Evils: Judging the Actionability of Intelligence in the 9/11 disaster." Under first review at *Organization Science*.

Bradley, Don E. & Roberts, James A. "Self-Employment and Job Satisfaction: Evidence from the National Survey of Families and Households." *Journal of Small Business Management*.

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Bradley, Don E. & Roberts, James A. "Facets of organizational job satisfaction and their impact on the decision to become self-employed." Working title.

Books

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How to exit gracefully

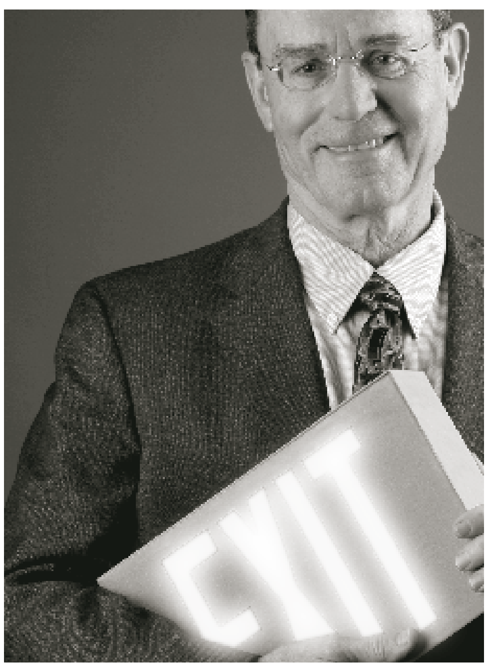
The man who opened several truck stops and then started a pay phone business to complement them probably didn't know he'd sell the latter company for millions of dollars. Likewise, the entrepreneur in the sunglasses business mostly likely didn't think about what he'd do after his original $5,000 loan turned into a business with $70 million in revenue.

Both of these entrepreneurs had a vision, worked hard, and reaped the benefits.

But then what?

What happened to them when they decided to sell out?

That question was the point of research conducted by Bill Petty, professor of finance and W.W. Caruth Chair for Entrepreneurship, who studied both companies. He wanted to discover what happened when the founders prepared to sell. How did they know it was time? What steps did they follow? What happened when the deal was done?



Bill Petty

Petty and partners John Martin, also a professor of finance at Baylor, and John Kensinger of the University of North Texas, interviewed about 30 entrepreneurs as part of their research for the former Financial Executive Institute, now Financial Executive International. The association of about 14,000 chief financial officers sought the research because many of their members faced the issue of "cashing out" and the problems associated with it.

The issue of selling for millions of dollars a company you built from scratch appears deceptively simple. You worked hard, you profited, you reaped the benefits during the sale, and now you spend your money. Right?

Not unless you've taken the time to get to know yourself, researchers say.

In addition to the sunglasses and pay phone businesses, Petty, Martin and Kensinger interviewed venture capitalists, owners and entrepreneurs from companies across the country. Some were not the founding owners. Instead, they entered the businesses as part of the management team, eventually became CEO, got ownership equity, and cashed out. "We talked to companies that sold out, that did IPOs, and that sold their companies to employees in a stock ownership plan," said Petty.

What he and his counterparts discovered was lots of planning and work on the front end and in the middle, but very little on the exiting end. "They dream about and plan and strategize about starting a company and growing it, but rarely think about the exit," he said. "They think about building and growing and growing and growing, then something happens." That something could be health, marital or family problems that make them feel like they have to sell. "The purpose of the sale is multi-fold, as is the purpose of the exit," he said.

When these leaders sell their companies or take them public, they are trying to unlock the value of the business, said Petty. The value to the builder of the business has a lot to do with non-financial matters, he notes. These include what the CEO really enjoys doing and whether the industry is maturing. "A big issue is, the company is a part of you and you are a part of the company," he said. "There's a lot of seller's regret or remorse."

He discovered that although company owners can hire accountants and lawyers to handle the technical side of the business, they needed to handle the personal side themselves. "They had to really understand their personal side," he said. "They needed to talk to people who had been through it before."

Petty listed these exit strategies that he and his fellow researchers learned after interviewing entrepreneurs who left their businesses:

- Cash is important. Most of the entrepreneurs encouraged others in the same situation to negotiate for cash rather than stock. "One of the people got some cash and a lot of stock. Two weeks later, the stock was worth half of what it had been because of problems in the industry," said Petty.
- Avoid seller's regret by understanding who you are and what's important to you.
- Run the firm from the beginning as if you plan to harvest. Don't mix up personal and business items, said Petty, or the buyer won't know one from the other. "Run it clean, as if you do plan to harvest."
- CEOs should expect culture clashes if they stay on after the sale. Petty's team found that of those entrepreneurs who stayed on, 80 percent of them saw culture clashes develop. This happens when the founders run into philosophical differences with the new owners.
- Buying a company does not prepare you to sell your own company. "There's an emotion involved when you're selling that's not involved when you are buying," he said. "You see it differently — not always rationally."
- Entrepreneurs know how much they will accept for their companies, but they may not know the value of the business. Independent valuations may be higher or lower than what the founder believes it is worth. One investment group told Petty that it preferred dealing with an entrepreneur who had already talked to prospective buyers and had a good idea of what his company was really worth.
- During negotiations, don't lose focus on your business. Once a company founder decides to exit, he often focuses on that. If the sale does not go through, he is back to where he was plus his company has lost momentum.
- IPOs are not for everyone. A lot of entrepreneurs like the idea of taking their company public and think an IPO is the "end of all ends," said Petty. Then they discover that being in a publicly traded company is expensive, time-consuming and distracting — in short, not as much fun.
- Picking the right time to exit is difficult. "It really is hard to recognize whether it's time to exit or time to grow the company," noted Petty. "If they stay and the industry goes into decline, they will regret it. If they don't stay and the industry grows, they will miss the growth opportunity and regret it."

An overall strategy for exiting your business is to have two tracks, said Petty. "You've been on one track for 15 or 20 years. You need another to get onto or you very likely will have seller's remorse. So many relationships people have are through their business. Life changes and you really do have to understand how it will change."

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