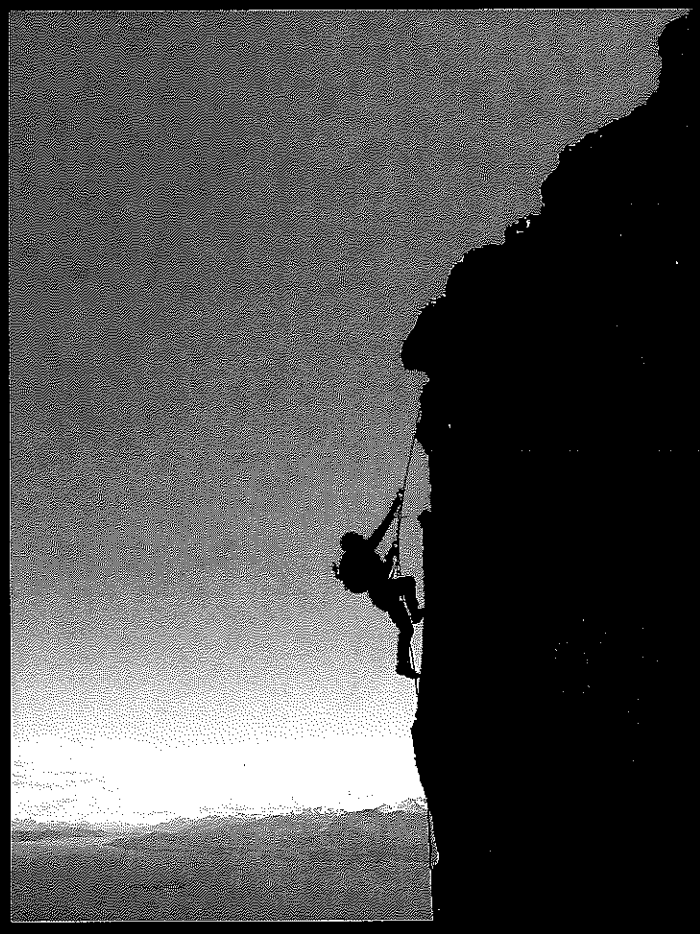
Entrepreneurship

Eighth Edition

Robert Hisrich



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ENTREPRENEURIAL STRATEGY: GENERATING AND EXPLOITING NEW ENTRIES

LEARNING OBJECTIVES

1
To understand that the essential act of entrepreneurship involves new entry.

2
To be able to think about how an entrepreneurial strategy can first generate, and then exploit over time, a new entry.

3
To understand how resources are involved in the generation of opportunities.

4
To be able to assess the attractiveness of a new entry opportunity.

5
To acknowledge that entrepreneurship involves making decisions under conditions of uncertainty.

6
To be able to assess the extent of first-mover advantages and weigh them against first-mover disadvantages.

7
To understand that risk is associated with newness, but there are strategies that the entrepreneur can use to reduce risk.

OPENING PROFILE

JUSTIN PARER

> Sorry it had taken so long to get back to you. I think in some way I have been avoiding this because I don't know if I actually know the answers to what you are asking. I think sometimes you justify afterwards why you did something.

This quote is from Justin Parer, an Australian entrepreneur, in response to my direct questions about the plan he followed for entrepreneurial success. His history indicates a series of steps and missteps that have emerged into a strategy of personal and business success—a strategy that may be more obvious to the objective observer taking a long-run perspective than to the actor who is immersed in the daily details of a pressurized situation and is making "intuitive" decisions.

Justin's first entrepreneurial venture failed. The story is not pretty. He started up a mobile pizza business when he was 18 years old. "The idea for the van was actually someone else's. I was working in a pizza shop as a delivery driver trying to decide what I wanted to do in my life. I had recently been thrown out of uni [university] for gross failing and was at a loose end. One of the other guys in the shop said, 'Why don't they sell pizzas outside night clubs?' The market at the time was being serviced by a number of very unhygienic hot dog vendors who operated out of questionable mobile huts." Eventually Justin's business failed because, among other things, the local council terminated permits for these types of mobile food businesses.

When asked about the failed business, Justin's first comment was that it was the best learning experience of his life. His second comment was that it was a great motivator. It provided motivation "to avoid that sick feeling that rips at your guts when you know things are not going well and you can't pay your bills," to "face reality," and where necessary to "cut your losses" and get out.

He went on to say: "I am not sure that straight after the failure I was that motivated to get back into it. I knew I enjoyed business and was frustrated that I couldn't make it work, but I felt more like a failure than a 'success waiting to happen.' My confidence was hurt and I was looking for a lot more security. How was I ever [going] to buy a house? Have a family? I had few options and no clear vision, so when the opportunity came along to go back to university, I grabbed it with both hands. With the pizza van failure I knew I could work like a dog and get nowhere. I needed to have an edge. University gave me options."

Justin's second attempt at university had no resemblance to his first attempt. He had become an exceptional student with a passion to learn and a passion to apply that knowledge. He majored in accounting and his first job out of university was with Ernst & Young (an accounting consulting firm). Accounting education and experience provided valuable knowledge about the inner workings of a business (with the auditing department) and the numbers reflecting the entrepreneurial decision-making process (in the business services and tax department). Over and above the opportunity to build important knowledge, Justin also chose accounting as the foundation from which to relaunch his entrepreneurial career because it gave him legitimacy with others in the business community (including potential stakeholders), helped him build a large network with influential people, and would act as an income "insurance policy" if his business failed.

One of Justin's accounting clients was a slipway (ship building and repair) business. From this work he was able to gain considerable industry-specific knowledge and an industry-specific network. This newly formed network provided early information about a business in the industry that might come on the market, and his new industry-specific knowledge meant that he could assess the value of this opportunity. He bought the business and is growing it while simultaneously improving its efficiency. The success of the business has even exceeded his own dreams for it at the time of purchase.

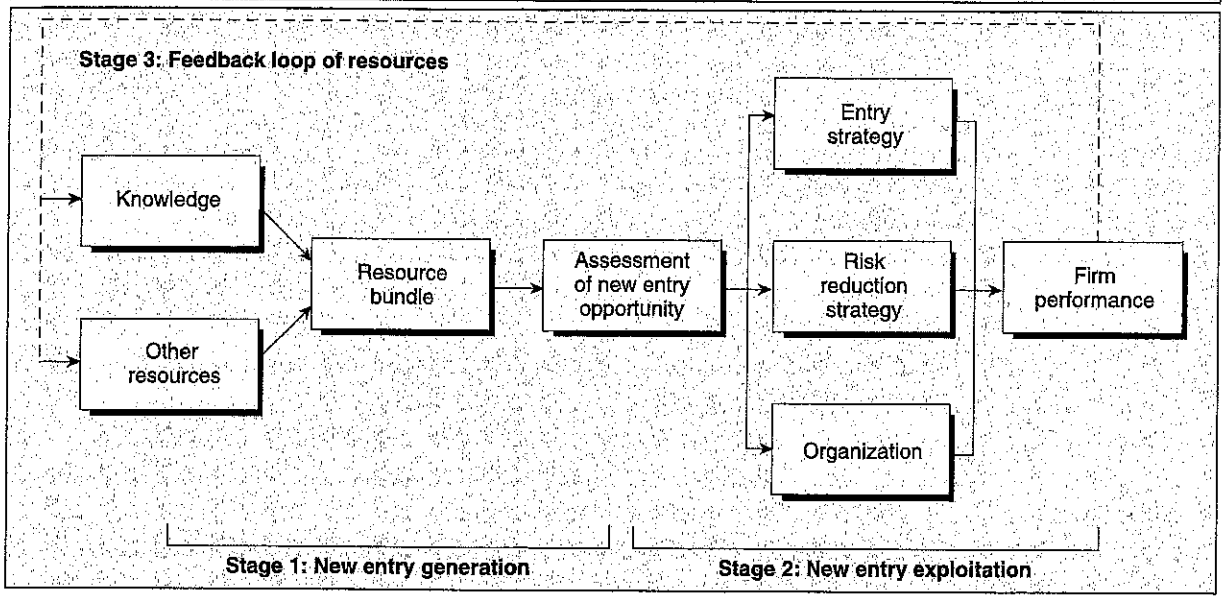
He has recently gone into partnership with his brother Warwick and purchased another business—a metal-working business. This business has considerable potential in its own right but has the added benefit of synergies with the slipway. This business is also on the path to success. When I think of the "ideal" entrepreneur, I think of Justin. Justin is an optimistic and charismatic entrepreneur who attacks his tasks and life with confidence and passion (with the possible exception of answering questions about his success). He has control over the money side of his businesses but also has the flexibility to allow his strategies to emerge.

NEW ENTRY

new entry Offering a new product to an established or new market, offering an established product to a new market, or creating a new organization

One of the essential acts of entrepreneurship is new entry. *New entry* refers to (1) offering a new product to an established or new market, (2) offering an established product to a new market, or (3) creating a new organization (regardless of whether the product or the market is new to competitors or customers).[1] Whether associated with a new product, a new market, and/or a new organization, "newness" is like a double-edged sword. On the one hand, newness represents something rare, which can help differentiate a firm from its competitors. On the other hand, newness creates a number of challenges for entrepreneurs. For example, newness can increase entrepreneurs' uncertainty over the value of a new product and place a greater strain on the resources necessary for successful exploitation.[2]

FIGURE 3.1 Entrepreneurial Strategy: The Generation and Exploitation of New Entry Opportunities



entrepreneurial strategy The set of decisions, actions, and reactions that first generate, and then exploit over time, a new entry

Entrepreneurial strategy represents the set of decisions, actions, and reactions that first generate, and then exploit over time, a new entry in a way that maximizes the benefits of newness and minimizes its costs.

Figure 3.1 illustrates the important elements of an entrepreneurial strategy. An entrepreneurial strategy has three key stages: (1) the generation of a new entry opportunity, (2) the exploitation of a new entry opportunity, and (3) a feedback loop from the culmination of a new entry generation and exploitation back to stage 1. The generation of a new entry is the result of a combination of knowledge and other resources into a bundle that its creators hope will be valuable, rare, and difficult for others to imitate. If the decision is that the new entry is sufficiently attractive that it warrants exploitation, then firm performance is dependent upon the entry strategy; the risk reduction strategy; the way the firm is organized; and the competence of the entrepreneur, management team, and the firm.

Although the remainder of this chapter focuses on stages 1 and 2, we should not underestimate the importance of the feedback loop of stage 3 because an entrepreneur cannot rely on the generation and exploitation of only one new entry; rather, long-run performance is dependent upon the ability to generate and exploit numerous new entries. If the firm does rely on only one new entry, then as the life cycle for the product enters maturity and declines, so goes the life cycle of the organization.

GENERATION OF A NEW ENTRY OPPORTUNITY

Resources as a Source of Competitive Advantage

When a firm engages in a new entry, it is hoped that this new entry will provide the firm with a sustainable competitive advantage. Understanding where a sustainable competitive advantage comes from will provide some insight into how entrepreneurs can generate new entries that are likely to provide the basis for high firm performance over an extended

resources The inputs into the production process

period of time. *Resources* are the basic building blocks to a firm's functioning and performance. A firm's resources are simply the inputs into the production process, such as machinery, financial capital, and skilled employees.

These resources can be combined in different ways, and it is this bundle of resources that provides a firm its capacity to achieve superior performance. For example, a highly skilled workforce represents an important resource, but the impact of this resource on performance is magnified when it is combined with an organizational culture that enhances communication, teamwork, and innovativeness. To truly understand the impact of a resource, we need to consider the bundle rather than just the resources that make up the bundle.

For a bundle of resources to be the basis of a firm's superior performance over competitors for an extended period of time, the resources must be valuable, rare, and inimitable (including nonsubstitutable).[3] A bundle of resources is:[4]

- Valuable when it enables the firm to pursue opportunities, neutralize threats, and offer products and services that are valued by customers.
- Rare when it is possessed by few, if any, (potential) competitors.
- Inimitable when replication of this combination of resources would be difficult and/or costly for (potential) competitors.

For example, Breeze Technology Incorporated appeared to have a bundle of resources that was valuable, rare, and inimitable. It had invented a technology that could be applied to the ventilation of athletic shoes to reduce foot temperature. A ventilated athletic shoe is likely to be highly valued by customers because people have problems with their current athletic shoes—their feet get hot and sweaty, which in turn causes blisters, fungal infections, and odor. (I know my wife would be happy for me to wear shoes that reduced foot odor.) The product was also valuable to the newly formed management team of Breeze Technology because it provided the means of entering into a large and highly lucrative market.

This technology also appeared to be rare and inimitable. It was rare because others had failed to adequately ventilate people's feet. Some had attempted to blow air into the shoe and found that it only increased foot temperature. Current footwear attempted to passively ventilate feet, but the porous uppers on shoes were relatively ineffective at this task and also made the shoe vulnerable to water intrusion—that is, if you stepped into a puddle, your feet would get wet. Breeze Technology pumped air out of the shoe, which was a novel and unobvious approach to shoe ventilation.

Given that this technology was deemed likely to be valuable to customers, novel, and unobvious, it was provided a patent. The purpose of the patent is to protect the owner of the technology from people imitating the technology. Along with other intellectual property protection such as copyrights and trademarks, Breeze Technology had a new product that could be protected from competition (at least for a period of time). Therefore, Breeze Technology had a bundle of resources that was valuable, rare, and inimitable. The important questions are, then: (1) where does this valuable, rare, and difficult-to-imitate bundle of resources come from? and (2) how can it best be exploited?

entrepreneurial resource The ability to obtain, and then recombine, resources into a bundle that is valuable, rare, and inimitable

Creating a Resource Bundle That Is Valuable, Rare, and Inimitable

The ability to obtain, and then recombine, resources into a bundle that is valuable, rare, and inimitable represents an important *entrepreneurial resource*. Knowledge is the basis of this entrepreneurial resource, which in itself is valuable. This type of knowledge is built up over time through experience, and it resides in the mind of the entrepreneur

and in the collective mind of management and employees. To a large extent such an experience is idiosyncratic—unique to the life of the individual—and therefore can be considered rare. Furthermore, it is typically difficult to communicate this knowledge to others, which makes it all the more difficult for (potential) competitors to replicate such knowledge.

Therefore, knowledge is important for generating a bundle of resources that will lead to the creation of a new venture with a long and prosperous life. Does this mean that only highly experienced managers and/or firms will typically generate these opportunities for new entry? On the contrary, the evidence suggests that it is the outsiders that come up with the most radical innovations. For example, the pioneers of mountain bikes were biking enthusiasts, and it was quite a considerable time before the industry giants, such as Schwinn and Huffy, reacted to the trend.[5]

It appears that the existing manufacturers of bikes had difficulty "thinking outside the box" or they had little incentive to do so. Notice that those who did invent the mountain bike were bike enthusiasts. They had knowledge about current technology and the problems that customers (themselves included) had with the current technology under certain circumstances. This knowledge was unique and based upon personal experience. It was this knowledge that provided the basis for their innovation.

Those wishing to generate an innovation need to look to the unique experiences and knowledge within themselves and their team. This sort of knowledge is unlikely to be learned in a textbook or in class, because then everyone would have it and what would be unique about that? Knowledge that is particularly relevant to the generation of new entries is that which is related to the market and technology.

market knowledge Possession of information, technology, know-how, and skills that provide insight into a market and its customers

Market Knowledge *Market knowledge* refers to the entrepreneur's possession of information, technology, know-how, and skills that provide insight into a market and its customers. Being knowledgeable about the market and customers enables the entrepreneur to gain a deeper understanding of the problems that customers have with the market's existing products. In essence the entrepreneur shares some of the same knowledge that customers have about the use and performance of products. From this shared knowledge, entrepreneurs are able to bring together resources in a way that provides a solution to customers' dissatisfaction.

In this case, the entrepreneur's market knowledge is deeper than the knowledge that could be gained through market research. Market research, such as surveys, has limited effectiveness because it is often difficult for customers to articulate the underlying problems they have with a product or service. Entrepreneurs who lack this intimate knowledge of the market, and of customers' attitudes and behaviors, are less likely to recognize or create attractive opportunities for new products and/or new markets.

The importance of this knowledge to the generation of a new entry is best illustrated by returning to the example of the invention of the mountain bike. These guys were bike enthusiasts and therefore were aware of the problems that they personally encountered, as well as the problems their friends encountered, in using bikes that relied on the current technology. It could be that these individuals were using their bikes in a way that was not anticipated by the bike manufacturers, such as taking them off-road and exploring rough terrain.

Market research would not likely have revealed this information about deficiencies in the current technology. It is difficult for people to articulate the need for something that does not exist. Besides, the manufacturers may have dismissed any information that they received. For example, "Of course the frame broke, this idiot was going 30 miles per hour down a stony hiking track." It was because these bike enthusiasts had an intimate knowledge of the market and customers' attitudes and behaviors that they were able to bring

together resources in a way that provided a solution to customers' dissatisfaction—the mountain bike represented a solution and opened up a new market.

technological knowledge Possession of information, technology, know-how, and skills that provide insight into ways to create new knowledge

Technological Knowledge *Technological knowledge* is also a basis for generating new entry opportunities. Technological knowledge refers to the entrepreneur's possession of information, technology, know-how, and skills that provide insight into ways to create new knowledge. This technological knowledge might lead to a technology that is the basis for a new entry, even though its market applicability is unobvious.

For example, the laser was invented over 30 years ago and has led to many new entry opportunities. Those with expertise in laser technology are more able to adapt and improve the technology and in doing so open up a potentially attractive market. Laser technology has been adapted to navigation, precision measurement, music recording, and fiber optics. In surgery, laser technology has been used to repair detached retinas and reverse blindness. These new entries were derived from the knowledge of laser technology, and market applicability was often of only secondary consideration.[6]

Similarly, the initial reaction to the invention of the computer was that its market was rather limited. If we investigate the application of the computer to one industry, we can see the sort of new markets that have arisen from the further development of computer technology. Computers are used in the aviation industry to conduct aerodynamic research to find efficient aircraft designs; in the automation of the navigation and flying functions of pilots, such as the autopilot; in the radar system used by air traffic control; in flight simulators used by airlines to train pilots on new aircraft; and in the computer network system for ticketing and tracking baggage (although my bags still seem to get lost).[7]

Therefore, technological knowledge has led to technological advancement that in many ways has created new markets rather than generating a technology to satisfy an unmet market need. Often these technologies were created by people wanting to advance knowledge, without concern for commercial applicability. Other times, a technology has been invented for a specific and narrow purpose only to find out later that the technology has broader implications. For example, Tang, freeze-dried coffee, Velcro, and Teflon were all products invented for the space program but were found to have broader applications.

In sum, a resource bundle is the basis for a new entry. This resource bundle is created from the entrepreneur's market knowledge, technological knowledge, and other resources. The new entry has the potential of being a source of sustained superior firm performance if the resource bundle underlying the new entry is valuable, rare, and difficult for others to imitate.

Assessing the Attractiveness of a New Entry Opportunity

Having created a new resource combination, the entrepreneur needs to determine whether it is in fact valuable, rare, and inimitable by assessing whether the new product and/or the new market are sufficiently attractive to be worth exploiting and developing. This depends on the level of information on a new entry and the entrepreneur's willingness to make a decision without perfect information.

Information on a New Entry

Prior Knowledge and Information Search The prior market and technological knowledge used to create the potential new entry can also be of benefit in assessing the attractiveness of a particular opportunity. More prior knowledge means that the entrepreneur starts from a position of less ignorance about the assessment task at hand. That is,

AS SEEN IN *ENTREPRENEUR* MAGAZINE

ELEVATOR PITCH FOR PROJECT ALABAMA

A wealthy friend has asked you to keep your eye out for attractive businesses in which she can invest. Your wealthy friend is very busy and you only want to introduce those businesses that are genuinely attractive. After hearing the following pitch, would you introduce Natalie and Enrico to your wealthy friend?

Entrepreneurs Natalie Chanin (41) and Enrico Marone-Cinzano (39), co-founders of Project Alabama in Florence, Alabama

Description Clothing company that largely uses recycled materials

Start-Up 2000 for $20,000

Sales Projecting $1.5 million in 2003

Helping Hands Heading to a party one night, Chanin hand-sewed a T-shirt and was hooked. With a costume design and fashion stylist background, Chanin joined forces with co-founder Marone-Cinzano, a businessman with experience in finance and marketing. She was unable to find a manufacturer in New York to do the handwork—her collection's resemblance to quilting inspired Chanin to return to her native Alabama and find "quilting circles" that could lend a hand (she now lives in both New York and Alabama, but spends most of her time in Alabama).

Recycled Goods Project Alabama's growth necessitates branching out to include new materials, but the core of the collection is made from recycled cotton jersey T-shirts. Retailing for $250 to $4,000, their target has always been high-end. "We made a conscious effort to contact those type of stores," explains Chanin. "Luckily, we had some of the world's best stores buy from the beginning, like Barneys New York and Browns in London."

Supplies Needed "Project Alabama consists of two components: the use of recycled materials and the quality of handwork," says Chanin, speaking proudly of the 120 women who subcontract stitchwork. "The kind of pride they have in each and every piece is rare."

Source: Reprinted with permission of Entrepreneur Media, Inc., "Natalie Chanin and Enrico Marone-Cinzano," by April Y. Pennington, February 2003, *Entrepreneur* magazine: www.entrepreneur.com.

less information needs to be collected to reach a threshold where the entrepreneur feels comfortable making a decision to exploit or not to exploit.

Knowledge can be increased by searching for information that will shed some light on the attractiveness of this new entry opportunity. Interestingly, the more knowledge the entrepreneur has, the more efficient the search process. For example, entrepreneurs who have a large knowledge base in a particular area will know where to look for information and will be able to quickly process this information into knowledge useful for the assessment.

The search process itself represents a dilemma for an entrepreneur. On the one hand, a longer search period allows the entrepreneur time to gain more information about whether this new entry does represent a resource bundle that is valuable, rare, and difficult for others to imitate. The more information the entrepreneur has, the more accurately she or he can assess whether sufficient customer demand for the product can be generated and whether the product can be protected from imitation by competitors.

However, there are costs associated with searching for this information—costs in both money and time. For example, rather than deciding to exploit a new product, an entrepreneur may decide to search for more information to make a more accurate assessment of whether this new product is an attractive one for her; but while this entrepreneur continues with her information search, the opportunity may cease to be available.

window of opportunity The period of time when the environment is favorable for entrepreneurs to exploit a particular new entry

Window of Opportunity The dynamic nature of the viability of a particular new entry can be described in terms of a *window of opportunity*. When the window is open, the

environment is favorable for entrepreneurs to exploit a particular new product or to enter a new market with an existing product; but the window of opportunity may close, leaving the environment for exploitation unfavorable. An example of a window of opportunity closing is when another entrepreneur has entered the industry and erected substantial barriers to entry and to imitation. While more information is desirable, the time spent in collecting additional information increases the likelihood that the window of opportunity will close.

Comfort with Making a Decision under Uncertainty

The trade-off between more information and the likelihood that the window of opportunity will close provides a dilemma for entrepreneurs. This dilemma involves a choice of which error they prefer to commit: Do they prefer to commit an error of commission over an error of omission, or vice versa?[8] An *error of commission* occurs from the decision to pursue this new entry opportunity, only to find out later that the entrepreneur had overestimated his or her ability to create customer demand and/or to protect the technology from imitation by competitors. The costs to the entrepreneur were derived from acting on the perceived opportunity.

error of commission
Negative outcome from acting

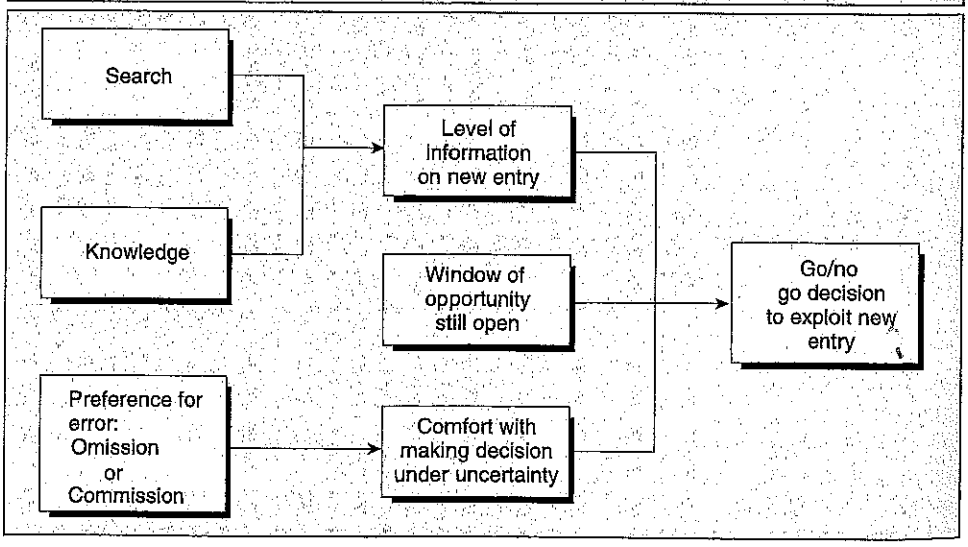
An *error of omission* occurs from the decision not to act on the new entry opportunity, only to find out later that the entrepreneur had underestimated his or her ability to create customer demand and/or to protect the technology from imitation by competitors. In this case, the entrepreneur must live with the knowledge that he let an attractive opportunity slip through his fingers.

error of omission
Negative outcome from not acting

Decision to Exploit or Not to Exploit the New Entry

As illustrated in Figure 3.2, the decision to exploit or not to exploit the new entry opportunity depends on whether the entrepreneur has what she or he believes to be sufficient information to make a decision, and on whether the window is still open for this

FIGURE 3.2 The Decision to Exploit or Not to Exploit the New Entry Opportunity



new entry opportunity. A determination by an entrepreneur that she has sufficient information depends on the stock of information (accumulated through search and from prior knowledge) and on the level of comfort that this entrepreneur has with making the decision without perfect information (which depends on a preference of one type of error over another).

assessment of a new entry's attractiveness Determining whether the entrepreneur believes she or he can make the proposed new entry work

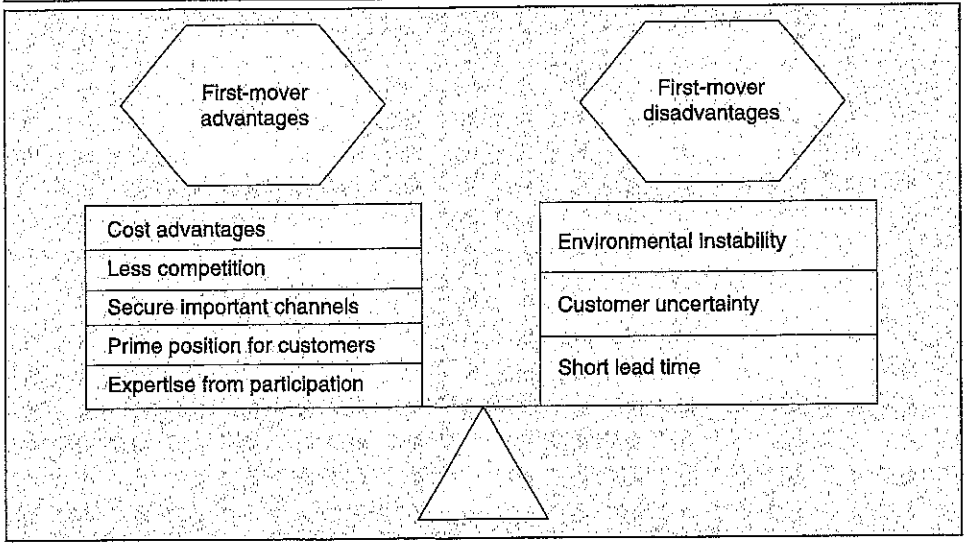
It is important to realize that the *assessment of a new entry's attractiveness* is less about whether this opportunity "really" exists or not and more about whether the entrepreneur believes he or she can make it work—that is, create the market demand, efficiently produce the product, build a reputation, and develop customer loyalty and other switching costs. Making it work depends, in part, on entrepreneurial strategies.

ENTRY STRATEGY FOR NEW ENTRY EXPLOITATION

The common catchphrase used by entrepreneurs when asked about their source of competitive advantage is, "Our competitive advantage comes from being first. We are the first movers." Whether they are the first to introduce a new product and/or the first to create a new market, these claims have some merit. Being first can result in a number of advantages that can enhance performance. These include:

- *First movers develop a cost advantage.* Being first to offer and sell a particular product to a specific market means that the first mover can begin movement down the "experience curve." The experience curve captures the idea that as a firm produces a greater volume of a particular product, the cost of producing each unit of that product goes down. Costs are reduced because the firm can spread its fixed costs over a greater number of units (economies of scale) as well as learn by trial and error over time (learning curve) to improve products and processes.[9]
- *First movers face less competitive rivalry.* Although first movers might initially have only a few customers, if they have correctly assessed the opportunity, the market will grow rapidly. Even though competitors will enter this growing market, the market share lost to new competitors will be more than compensated for by market growth. In fact, in the growth stage of the market, firms are more concerned with keeping up with demand than they are with taking actions, such as price cutting, to take market share from others.
- *First movers can secure important channels.* First movers have the opportunity to select and develop strong relationships with the most important suppliers and distribution channels. This may represent a barrier to those considering entry and may force those who do eventually enter to use inferior suppliers and distribution outlets.
- *First movers are better positioned to satisfy customers.* First movers have the chance to (1) select and secure the most attractive segments of a market, and (2) position themselves at the center of the market, providing an increased ability to recognize, and adapt to, changes in the market. In some cases, they may even (3) establish their product as the industry standard.
- *First movers gain expertise through participation.* First movers have the opportunity to (1) learn from the first generation of products and improve, for example, product design, manufacturing, and marketing; (2) monitor changes in the market that might be difficult or impossible to detect for those firms not participating in the market; and (3) build up their networks, which can provide early information about attractive opportunities. These learning opportunities may be available only to those participating in the market. In this case, knowledge is gained through learning-by-doing rather than through observing the practices of others (vicarious learning).

FIGURE 3.3 Factors That Influence the Decision to Enter the Market Now or to Delay Entry



First movers do not always prosper. Many first movers with new products in new markets have been surpassed by firms that entered later. For example, in the market for video recorders the first movers were Ampex and Sony, yet they were surpassed by JVC and Matsushita. Similarly, in the ballpoint pen market the first movers (Reynolds and Eversharp) disappeared, whereas later entrants (Parker and Bic) have been highly successful.

As illustrated by the scales in Figure 3.3, there are forces pushing toward first-mover advantages, but there are also environmental conditions that can push a first mover toward performance disadvantages. When considering whether to be one of the first to enter with a new product and/or into a new market, entrepreneurs must determine whether the first-mover advantages outweigh the first-mover disadvantages. Such an assessment depends on (1) the stability of the environment surrounding the entry, (2) the ability of the entrepreneur to educate customers, and (3) the ability of the entrepreneur to erect barriers to entry and imitation to extend the firm's lead time. We now explore each of these influences.

Environmental Instability and First-Mover (Dis)Advantages

The performance of a firm depends on the fit between its bundle of resources and the external environment. If there is a good fit between its resources and the external environment, then the firm will be rewarded with superior performance; however, if the fit is poor, then performance will also be poor. For example, if the entrepreneur offers a new product that has attributes that the market does not value, then there is a poor fit between the firm's current product offerings and the external environment and performance will be poor.[5]

key success factors The requirements that any firm must meet to successfully compete in a particular industry

To obtain a good fit with the external environment, the entrepreneur must first determine the key success factors of the industry being targeted for entry. *Key success factors* are the requirements that any firm must meet to successfully compete in a particular industry. For example, maybe the key success factor of an industry is superior service, or reliability, or the lowest price, or having one's technology adopted as the industry standard. However, the

first mover will not know these key success factors in advance; rather, the entrepreneur must commit the firm's resources based upon his or her best guess of what these key success factors might be. If the guess is correct and the environment remains stable, then the firm has a chance of achieving success. However, if the environment changes, so too will the key success factors, and, as a result, the entrepreneur's prior commitment of resources will be less effective and may even reduce the firm's ability to recognize and adapt to the new environment.

emerging industries Industries that have been newly formed and are growing

Environmental changes are highly likely in *emerging industries*. Emerging industries are those industries that have been newly formed. As such, the rules of the game have not yet been set. This means that the entrepreneur has considerable freedom in how he or she achieves success, including establishing the rules of the game for the industry such that the firm is at a competitive advantage. Until the rules of the game have been established and the industry has matured (aged), the environment of an emerging industry is often changing. Determining whether change will occur and the nature of that change is often difficult for entrepreneurs because they face considerable demand uncertainty and technological uncertainty. Even if the change is detected, it is difficult to respond effectively.

demand uncertainty Considerable difficulty in accurately estimating the potential size of the market, how fast it will grow, and the key dimensions along which it will grow

Demand Uncertainty First movers have little information upon which to estimate the potential size of the market and how fast it will grow. Such *demand uncertainty* makes it difficult to estimate future demand, which has important implications for new venture performance as both overestimating and underestimating demand can negatively impact performance. By overestimating demand, the entrepreneur will suffer the costs associated with overcapacity (there was no need to build such a large factory, for instance) and will find that the market may be so small that it cannot sustain the entrepreneur's business. By underestimating market demand, the entrepreneur will suffer the costs of undercapacity, such as not being able to satisfy existing and new customers and losing them to competitors, or will face the additional costs of incrementally adding capacity.

Demand uncertainty also makes it difficult to predict the key dimensions along which the market will grow. For example, customers' needs and tastes may change as the market matures. If the entrepreneur is unaware of these changes (or is incapable of adapting to them), then there is an opportunity for competitors to provide superior value to the customers. For example, as the personal computer industry matured, the key success factors changed from reputation for quality to being the low-cost provider. Dell was able to create a business model that enabled it to sell personal computers at a low price. Those that were late to adapt to the change in customer demand and continued to rely primarily on their reputation for quality were surpassed by Dell.

Entrepreneurs that delay entry have the opportunity to learn from the actions of first movers without the need of incurring the same costs. For example, Toyota delayed entry into the small-car market of the United States and was able to reduce demand uncertainty by surveying customers of the market leader (Volkswagen) and using this information to produce a product that better satisfied customers.[10] Therefore, followers have the advantage of more information about market demand. They also have more information about long-run customer preferences because the additional time before entry means that the market is more mature and customer preferences are more stable. Therefore, when demand is unstable and unpredictable, first-mover advantages may be outweighed by first-mover disadvantages and the entrepreneur should consider delaying entry.

Technological Uncertainty First movers often must make a commitment to a new technology. There are a number of uncertainties surrounding a new technology, such as

whether the technology will perform as expected and whether an alternate technology will be introduced that leapfrogs the current technology. If the technology does not perform as expected, the entrepreneur will incur a number of costs that will negatively impact performance, for example, damage to the entrepreneur's (and his or her firm's) reputation and also the additional R&D and production costs incurred by making necessary changes to the technology.

Even if the technology works as expected, there is the possibility that a superior technology might be introduced that provides later entrants a competitive advantage. For example, Docutel provided almost all the automatic teller machines in 1974. However, when technology became available that allowed customers to electronically transfer funds, companies such as Honeywell, IBM, and Burroughs were in a position to adopt the new technology and better satisfy customer demands. As a result, Docutel's market share dropped to 10 percent in just four years.[11]

technological uncertainty Considerable difficulty in accurately assessing whether the technology will perform and whether alternate technologies will emerge and leapfrog over current technologies

Delayed entry provides entrepreneurs with the opportunity to reduce *technological uncertainty*. For example, they can reduce technological uncertainty by learning from the first mover's R&D program. This could involve activities such as reverse engineering the first mover's products. This provides a source of technological knowledge that can be used to imitate the first mover's product (unless there is intellectual property protection) or to improve upon the technology. Delayed entry also provides the opportunity to observe and learn from the actions (and mistakes) of the first mover. For example, a first mover may enter a particular market segment only to find out that there is insufficient demand to sustain the business. The later entrant can learn from this failure and can avoid market segments that have proved themselves to be unattractive. Therefore, when technological uncertainty is high, first-mover advantages may be outweighed by first-mover disadvantages and the entrepreneur should consider delaying entry.

Adaptation Changes in market demand and technology do not necessarily mean that first movers cannot prosper. They do mean that the entrepreneur must adapt to the new environmental conditions. Such changes are difficult. The entrepreneur will likely find it difficult to move away from the people and systems that brought initial success and toward new configurations requiring changes to employees' roles and responsibilities as well as changes to systems. In other words, the organization has an inertia that represents a force for continuation that resists change. For example, Medtronics was the market leader in heart pacemakers but lost its position after it was slow to change from its existing technology to a new lithium-based technology. A new entrant, unconstrained by organizational inertia, was able to exploit and penalize Medtronics for its tardiness.[12]

In addition, the entrepreneurial attributes of persistence and determination, which are so beneficial when the new venture is on the "right course," can inhibit the ability of the entrepreneur to detect, and implement, change. For example, there is a tendency for entrepreneurs to escalate commitment; that is, when faced with a new technology, the entrepreneur commits more resources to his or her current technology and reinforces the initial strategic direction, rather than adopting the new technology and changing strategic direction,[13] which has the effect of accelerating the firm's demise. Therefore, adaptation to changes in the external environment is important for all firms (especially first movers) but is often a very difficult task to conduct in practice.

Customers' Uncertainty and First-Mover (Dis)Advantages

Whether introducing a new product into an established market or an established product into a new market, the entry involves an element of newness. Embedded in this newness is

uncertainty for customers Customers may have considerable difficulty in accurately assessing whether the new product or service provides value for them

uncertainty for customers. They may be uncertain about how to use the product and whether it will perform as expected. Even if it does perform, they may wonder to what extent its performance provides benefits over and above the products that are currently being used. Customers, like most people, are uncertainty averse, which means that even if the potential benefits of the new product are superior to existing products, customers may still not switch from the old to the new because of the uncertainties described earlier. Therefore, offering a superior product is not sufficient to enable a first mover to make sales; the entrepreneur must also reduce customer uncertainties.

To do this, the entrepreneur can offer informational advertising that, for example, provides customers with information about how the product performs and articulates the product's benefits. The entrepreneur may even use comparison marketing to highlight how the product's benefits outweigh those of substitute products. If this approach works, customers will be more likely to switch to the firm's product. The "home shopping" channels on television provide numerous examples of this informational advertising. For example, an advertisement describes a set of plastic bags into which clothes (or other things) may be inserted, and the air within the bags evacuated (using a vacuum cleaner), which substantially reduces the volume of the clothes and allows more to be packed into a suitcase (so much so that the weight of the case exceeds one's ability to lift it, as I learned by experience).

However, providing customers with information on the performance of a new product does not always work. When the new product is highly innovative, as are the products that create a new market, the customers may lack a frame of reference for processing this information.[14] For example, products developed for the purpose of national defense and for other high-technology government purposes may provide an opportunity for new entry but require that customers be given a context for understanding their application. Teflon, developed for use in construction of the space shuttle, required customers to develop a new frame of reference before they could understand how it performed as a nonstick surface in frying pans and the benefits to them from this surface.[15] Therefore, entrepreneurs may be faced with the challenging task of creating a frame of reference within the potential customers before providing informational advertising.

Potential customers' uncertainty may also stem from the broader context in which the product is to be used. For example, even if the potential customers understand how the product performs, they are unlikely to purchase a product until they are convinced that the product is consistent with enabling products, systems, and knowledge. For example, a customer may know that a new software package provides more powerful spreadsheet functions and at a lower price but will remain reluctant to purchase the new product until she or he knows how long it will take to learn how to use the new software. In this circumstance, the entrepreneur can educate customers through demonstration and documentation on how to use the product. This could include an extensive tutorial as part of the software package as well as a free "help line."

Those that decide to enter later face a market that is more mature and one in which customers' uncertainties have already been substantially reduced by those who pioneered the market. In essence, by delaying entry into a market that requires considerable education, the entrepreneur may be able to receive a free ride on the investments made by the first movers.

However, it still may pay to be a first mover in this type of market if the educational effort can be used for the firm's advantage rather than to the advantage of the industry as a whole. For example, education may direct customer preferences in ways that will give the firm an advantage over potential customers (e.g., it may create an industry standard around the firm's products); it might enable the entrepreneur to build a reputation as "founder,"

ETHICS

DO THE RIGHT THING

SMART ENTREPRENEURS ARE DOING WELL BY DOING GOOD

Charlie Wilson is trying to run an ethical business. He's made social responsibility part of the mission statement at his $1.6 million Houston-based salvage company, SeaRail International Inc. And he's made "self-actualization"—not wealth—his ultimate goal as an entrepreneur.

But don't mistake Wilson for some moralistic stick-in-the-mud. It's all about success. "Ethics is what's spearheading our growth," says Wilson. "It creates an element of trust, familiarity and predictability in the business. We're in an industry where a lot of people cut corners. I just don't think that's good for business. You don't get a good reputation doing things that way. And eventually, customers don't want to do business with you."

For years, ethics and business had a rocky marriage. Ask entrepreneurs to talk about ethics, and the responses ranged from scorn to ridicule. Here are folks who—by definition—like breaking the rules. Suggesting that entrepreneurs should follow a predefined set of edicts was about as popular as asking them to swear off electricity. But this may be changing. Whether people are hung over from the freewheeling '80s or reflective about the coming millennium, talk about values, integrity, and responsibility is not only becoming acceptable in the business community, it's almost required.

"This looks just like the quality movement of 20 years ago," says Frank Walker, chairman of Indianapolis-based Walker Information Inc., a research and consulting company that tracks customer satisfaction and business ethics. "Customers need a way to differentiate one firm from another." For years, the dominant point of differentiation has been quality. Now, says Walker, "Everyone can deliver quality, [so businesses] need to step up to a higher plane."

Are the nation's entrepreneurs ready to ascend to new heights of ethical literacy and compliance? Well, sort of. Although most entrepreneurs still aren't trying to unseat the likes of Socrates and Plato, many are giving considerable thought to improving their ethics, with hopes that doing good business will be good for business as well.

Source: Reprinted with permission of Entrepreneur Media, Inc., "Do the Right Thing," by Gayle Sato Stodder, August 1998, *Entrepreneur* magazine: www.entrepreneur.com.

encouraging customer loyalty; and it could benefit the company through the erection of other barriers to entry and imitation. We now explore the role of barriers to entry and imitation in influencing the performance of an entrepreneur's entry strategy.

Lead Time and First-Mover (Dis)Advantages

Being first to market might provide some initial advantages, but unless the entrepreneur can stop or retard potential competitors from entering the industry and offering similar products, the initial advantage will be quickly eroded, diminishing firm performance. Entry barriers provide the first mover (and nobody else) with the opportunity to operate in the industry for a grace period under conditions of limited competition (although the firm must still battle for customers with firms that offer substitute products). This grace period represents the first mover's lead time.

lead time The grace period in which the first mover operates in the industry under conditions of limited competition

The *lead time* gives the entrepreneur a period of limited competition to best prepare the firm for when competition does increase. This preparation could involve a concerted effort to influence the direction in which the market develops to the advantage of the first mover. For example, during the lead time the entrepreneur can use marketing to define quality in the minds of existing and potential customers—a definition of quality that is highly consistent with the entrepreneur's products.

Lead time can be extended if the first mover can erect barriers to entry. Important barriers to entry are derived from relationships with key stakeholders, which may dissuade entry by (potential) competitors. This can be done by:

Building customer loyalties. First movers need to establish their firms and their products in the minds of their customers and thus build customer loyalty. Such customer loyalty will make it more difficult and more costly for competitors to enter the market and take the first mover's customers. Loyalty is sometimes established when customers associate the industry with the first mover. For example, Japanese beer drinkers associated "super-dry beer" with the pioneer of a new form of beer, Asahi. This customer loyalty made it more difficult for others, including the dominant beer producer (Kirin), to enter the super-dry market and gain market share.

switching costs The costs that must be borne by customers if they are to stop purchasing from the current supplier and begin purchasing from another

Building switching costs. First movers need to develop *switching costs* in an effort to lock in existing customers. This is a mechanism by which customer loyalty is enhanced. Reward programs, such as frequent flyer points with a particular airline, establish for the customer a financial and/or emotional attachment to the first mover, which makes it costly for the customer to switch to a competitor.

Protecting product uniqueness. If the uniqueness of the product is a source of advantage over potential competitors, then first movers need to take actions to maintain that uniqueness. Intellectual property protection can take the form of patents, copyrights, trademarks, and trade secrets (detailed in Chapter 6).

Securing access to important sources of supply and distribution. First movers that are able to develop exclusive relationships with key sources of supply and/or key distribution channels will force potential entrants to use less attractive alternatives or even to develop their own. For example, Commercial Marine Products was the first to find an infestation of a special kind of seaweed in Tasmania, Australia. This seaweed is called *wakame* and is a staple food for Japanese and Koreans. Commerical Marine Products was able to obtain an exclusive license to manage and harvest this area of the Tasmanian coast, the only known location in Australia (and possibly the Southern Hemisphere) where wakame was growing. Being first meant that Commercial Marine Products was able to secure the only source of supply.

These barriers to entry can reduce the amount of competition faced by the first mover. Because competition typically puts downward pressure on prices and may increase marketing costs, it usually results in reduced profit margins and a drop in overall profitability. However, competition is not always bad; sometimes it can enhance the firm's performance. Competition within an industry can have a positive effect on industry growth. For example, competition among firms encourages them to become efficient and innovative to create even more value in their products for customers. Increases in customer value (whether from increases in product quality, lower prices, or both) will mean that more customers will enter the new market. New customers might be added by entering international markets.

Therefore, first movers need to keep in mind that they might win the battle by lowering the level of potential competition within an industry through the creation of barriers to entry but lose the war because insufficient customers are willing to substitute into the new industry. Under these conditions the first mover should consider allowing a number of competitors into the industry to share the pioneering costs and then working together to erect barriers to subsequent entry by potential competitors.

AS SEEN IN *ENTREPRENEUR* MAGAZINE

PROVIDE ADVICE TO AN ENTREPRENEUR ABOUT BEING MORE INNOVATIVE

When Neil Franklin began offering round-the-clock telephone customer service in 1998, customers loved it. The offering fit the strategic direction Franklin had in mind for Dataworkforce, his Dallas-based telecommunications-engineer staffing agency, so he invested in a phone system to route after-hours calls to his 10 employees' home and mobile phones. Today, Franklin, 38, has nearly 50 employees and continues to explore ways to improve Dataworkforce's service. Twenty-four-hour phone service has stayed, but other trials have not. One failure was developing individual Web sites for each customer. "We took it too far and spent $30,000, then abandoned it," Franklin recalls. A try at globally extending the brand by advertising in major world cities was also dropped. "It worked pretty well," Franklin says, "until you added up the cost."

Franklin's efforts are similar to an approach called a "portfolio of initiatives" strategy. The idea, according to Lowell Bryan, a principal in McKinsey & Co., the New York City consulting firm that developed it, is to always have a number of efforts under way to offer new products and services and attack new markets or otherwise implement strategies, and to actively manage these experiments so you don't miss an opportunity or overcommit to an unproven idea.

The portfolio of initiatives approach addresses a weakness of conventional business plans—that they make assumptions about uncertain future developments, such as market and technological trends, customer responses, sales, and competitor reactions. Bryan compares the portfolio of initiatives strategy to the ship convoys used in World War II to get supplies across oceans. By assembling groups of military and transport vessels and sending them in a mutually supportive group, planners could rely on at least some reaching their destination. In the same way, entrepreneurs with a portfolio of initiatives can expect some of them to pan out.

MAKING A PLAN

Three steps define the portfolio of initiatives approach. First, you search for initiatives in which you have or can readily acquire a familiarity advantage—meaning you know more than competitors about a business. You can gain familiarity advantage using low-cost pilot programs and experiments or by partnering with more knowledgeable allies. Avoid businesses in which you can't acquire a familiarity advantage, Bryan says.

After you identify familiarity-advantaged initiatives, begin investing in them using a disciplined, dynamic management approach. Pay attention to how initiatives relate to each other. They should be diverse enough that the failure of one won't endanger the others, but should also all fit into your overall strategic direction. Investments, represented by product development efforts, pilot programs, market tests, and the like, should start small and increase only as they prove themselves. Avoid overinvesting before initiatives have proved themselves. The third step is to pull the plug on initiatives that aren't working out, and step up investment in others. A portfolio of initiatives will work in any size company. Franklin pursues 20 to 30 at any time, knowing 90 percent won't pan out. "The main idea is to keep those initiatives running," he says. "If you don't, you're slowing down."

ADVICE TO AN ENTREPRENEUR

An entrepreneur who wants his firm to be more innovative has read the above article and comes to you for advice:

1. This whole idea of experimentation seems to make sense, but all these little failures can add up, and if there are enough of them, then this could lead to one big failure—the business going down the drain. How can I best get the advantages of experimentation in terms of innovation while also reducing the costs so that I don't run the risk of losing my business?
2. My employees, buyers, and suppliers like working for my company because we have a lot of wins. I am not sure how they will take it when our company begins to have a lot more failures (even if those failures are small)—it is a psychological thing. How can I handle this trade-off?
3. Even if everyone else accepts it, I am not sure how I will cope. When projects fail it hits me pretty hard emotionally. Is it just that I am not cut out for this type of approach?

Source: Reprinted with permission of Entrepreneur Media, Inc., "Worth a Try. Who Knows What's Going to Work? So Put as Many Ideas as You Can to the Test," by Mark Henricks, February 2003, *Entrepreneur* magazine: www.entrepreneur.com.

RISK REDUCTION STRATEGIES FOR NEW ENTRY EXPLOITATION

risk The probability, and magnitude, of downside loss

A new entry involves considerable risk for the entrepreneur and his or her firm. *Risk* here refers to the probability, and magnitude, of downside loss,[16] which could result in bankruptcy. The risk of downside loss is partly derived from the entrepreneur's uncertainties over market demand, technological development, and the actions of competitors. Strategies can be used to reduce some or all of these uncertainties and thereby reduce the risk of downside loss. Two such strategies are market scope and imitation.

Market Scope Strategies

scope A choice about which customer groups to serve and how to serve them

Scope is a choice by the entrepreneur about which customer groups to serve and how to serve them.[17] The choice of market scope ranges from a narrow- to a broad-scope strategy and depends on the type of risk the entrepreneur believes is more important to reduce.

Narrow-Scope Strategy A narrow-scope strategy offers a small product range to a small number of customer groups to satisfy a particular need. The narrow scope can reduce the risk that the firm will face competition with larger, more established firms in a number of ways.

- A narrow-scope strategy focuses the firm on producing customized products, localized business operations, and high levels of product quality. Such outcomes provide the basis for differentiating the firm from larger competitors who are oriented more toward mass production and the advantages that are derived from that volume. A narrow-scope strategy of product differentiation reduces competition with the larger established firms and allows the entrepreneur to charge premium prices.
- By focusing on a specific group of customers, the entrepreneur can build up specialized expertise and knowledge that provide an advantage over companies that are competing more broadly. For instance, the entrepreneur pursuing a narrow-scope strategy is in the best position to offer superior product quality, given his or her intimate knowledge of the product attributes customers desire most.
- The high end of the market typically represents a highly profitable niche that is well suited to those firms that can produce customized products, localized business operations, and high levels of product quality. From the first point listed, we know that firms pursuing a narrow-scope strategy are more likely to offer products and services with these attributes than are larger firms that are more interested in volume.

However, a narrow-scope strategy does not always provide protection against competition. For example, the firm may offer a product that the entrepreneur believes is of superior quality, yet customers may not value the so-called product improvements or, if they do perceive those improvements, they may be unwilling to pay a premium price for them, preferring to stick with the products currently being offered by the larger firms. That is, the boundary between the market segment being targeted by the entrepreneur and that of the mass market is not sufficiently clear and thus provides little protection against competition.

Furthermore, if the market niche is attractive, there is an incentive for the larger and more established firms (and all firms) to develop products and operations targeted at this niche. For example, a larger, more mass market–oriented firm might create a subsidiary to compete in this attractive market segment.

Although a narrow-scope strategy can sometimes reduce the risks associated with competition, this scope strategy is vulnerable to another type of risk: the risk that market demand does not materialize as expected and/or changes over time. For example, a narrow-scope

strategy focuses on a single customer group (or a small number of customer groups), but if the market changes and decreases substantially the size and attractiveness of that market segment, then the firm runs a considerable risk of downside loss. Having a narrow-scope strategy is like putting all your eggs in one basket. If that basket is fundamentally flawed, then all the eggs will be dropped and broken. A broad-scope strategy, on the other hand, provides a way of managing demand uncertainty and thereby reducing an aspect of the entrepreneur's risk.

Broad-Scope Strategy A broad-scope strategy can be thought of as taking a "portfolio" approach to dealing with uncertainties about the attractiveness of different market segments. By offering a range of products across many different market segments, the entrepreneur can gain an understanding of the whole market by determining which products are the most profitable. Unsuccessful products (and market segments) can then be dropped and resources concentrated on those product markets that show the greatest promise. In essence, the entrepreneur can cope with market uncertainty by using a broad-scope strategy to learn about the market through a process of trial and error.[18]

The entrepreneur's ultimate strategy will emerge as a result of the information provided by this learning process. In contrast, a narrow-scope strategy requires the entrepreneur to have sufficient certainty about the market that he is willing to focus his resources on a small piece of the market, with few options to fall back on if the initial assessment about the product proves incorrect. Offering a range of products across a range of market segments means that a broad-scope strategy is opening the firm up to many different "fronts" of competition. The entrepreneur may need to compete with the more specialized firms within narrow market niches and simultaneously with volume producers in the mass market.

Therefore, a narrow-scope strategy offers a way of reducing some competition-related risks but increases the risks associated with market uncertainties. In contrast, a broad-scope strategy offers a way of reducing risks associated with market uncertainties but faces increased exposure to competition. The entrepreneur needs to choose the scope strategy that reduces the risk of greatest concern. For example, if the new entry is into an established market, then competitors are well entrenched and ready to defend their market shares. Also the market demand is more stable and market research can inform the entrepreneur on the attractiveness of the new product with a particular group of customers. In this situation, where the risk of competition is great and market uncertainties are minimal, a narrow-scope strategy is more effective at risk reduction.

However, if new entry involves the creation of a new market or entry into an emerging market, then competitors are more concerned with satisfying new customers entering the market than on stealing market share from others or retaliating against new entrants. Also there is typically considerable market uncertainty about which products are going to be winners and which are going to be losers. In this situation, a broad-scope strategy reduces the major risk, namely, risks associated with uncertainties over customer preferences.

Imitation Strategies

Why Do It? Imitation is another strategy for minimizing the risk of downside loss associated with new entry. Imitation involves copying the practices of other firms, whether those other firms are in the industry being entered or from related industries. This idea of using *imitation strategies* to improve firm performance at first appears inconsistent with the argument at the start of the chapter that superior performance arises from the qualities of being valuable, rare, and inimitable. An imitation strategy cannot be rare or inimitable.

imitation strategies Copying the practices of other firms

Although this may be true, an imitation strategy can still enhance firm performance because a successful new entry does not need to be valuable, rare, and inimitable in terms of

every aspect of the firm's operations. Rather, imitation of others' practices that are peripheral to the competitive advantage of the firm offers a number of advantages.

Entrepreneurs may simply find it easier to imitate the practices of a successful firm than to go through the process of a systematic and expensive search that still requires a decision based on imperfect information.[19] In essence, imitation represents a substitute for individual learning and is well illustrated by the following quote from the president of Rexhaul Industries (a firm that sells cheaper recreational vehicles than its competitors): "In this industry, we call it R&C: research and copy."[20]

Imitating some of the practices of established successful firms can help the entrepreneur develop the skills necessary to be successful in the industry, rather than attempting to work out which skills are required and develop these skills from scratch. This use of imitation allows the entrepreneur to quickly acquire the skills that will be rewarded by the industry without necessarily having to go through the process of first determining what those key success factors actually are. It is a mechanism that allows the entrepreneur to skip a step in the stages of solving a puzzle (or at least to delay the need, and the importance, of solving that particular step).

Imitation also provides organizational legitimacy. If the entrepreneur acts like a well-established firm, it is likely to be perceived by customers as well established. Imitation is a means of gaining status and prestige. Customers feel more comfortable doing business with firms that they perceive to be established and prestigious. This is particularly the case for service firms. For example, a new consulting firm will need to go out of its way to look like an established prestigious firm, even though some of its trappings (e.g., a prime location office, leather chairs and couches, and a well-tailored suit) put a strain on resources and are only incidental to the quality of the service.

Types of Imitation Strategies Franchising is an example of a new entry that focuses on imitation to reduce the risk of downside loss for the franchisee. A franchisee acquires the use of a "proven formula" for new entry from a franchisor. For example, an entrepreneur might enter the fast food industry by franchising a McDonald's store in a new geographic location. This entrepreneur is imitating the business practices of other McDonald's stores (in fact, imitation is mandatory) and benefits from an established market demand; an intellectual property–protected name and products; and access to knowledge of financial, marketing, and managerial issues.

This new entry is unique because it is the only McDonald's store in a dedicated geographical area (although it must compete with Burger King, KFC, etc.) More broadly, this McDonald's store is differentiated from potential competitors in the same geographic space. Much of the risk of new entry for the entrepreneur has been reduced through this imitation strategy (Chapter 14 discusses franchising in more detail).

Franchising is not the only imitation strategy. Some entrepreneurs will attempt to copy successful businesses. For example, new entry can involve copying products that already exist and attempting to build an advantage through minor variations. This form of imitation is often referred to as a *"me-too" strategy*. In other words, the successful firm occupies a prime position in the minds of customers, and now the imitator is there too and hopes to be considered by the customers. Variation often takes the form of making minor changes to the launch product being offered, taking an existing product or service (which is unprotected by intellectual property rights) to a new market not currently served, or delivering the product to customers in a different way.

"me-too" strategy Copying products that already exist and attempting to build an advantage through minor variations

Ice cream shops are an example of a "me-too" imitation strategy, where new entrants have imitated successful stores but have also been able to differentiate themselves from those already in the industry by offering some form of variation. We have seen competing ice cream shops imitate each other by offering similar shop layouts and locations

(e.g., inside malls), the same choice of flavors and cones (e.g., waffle cones), and similar promotional strategies (such as, "Taste before you buy"). Often the point of variation is simply the location of the store.

In the ice cream retail industry we have noticed that new entrants are increasingly relying on even greater levels of imitation to provide the necessary competitive advantage—more and more new entrants are entering into a franchise agreement with Baskin-Robbins, Häagen-Dazs, or other international franchisors. These franchisors have introduced a national or global brand name and reputation (previously only regional), standardized operating procedures, interstore communication, and economies of scale in marketing.[21]

However, a "me-too" imitation strategy might be more difficult to successfully implement than first expected. The success of the firm being copied may depend on its underlying organizational knowledge and corporate culture. Peripheral activities may not produce the desired outcomes when used in a different organizational context. Furthermore, entrepreneurs are often legally prevented from other avenues of imitation, such as the use of registered trademarks and brand names.

Overall, an imitation strategy can potentially reduce the entrepreneur's costs associated with research and development, reduce customer uncertainty over the firm, and make the new entry look legitimate from day one. In pursuing an imitation strategy for new entry, the entrepreneur should focus on imitating those elements of the business that are not central to the firm's competitive advantage. These central aspects of advantage must be valuable, rare, and inimitable for the firm to achieve high performance over an extended period of time.

Managing Newness

New entry can occur through the creation of a new organization. The creation of a new organization offers some challenges not faced by entrepreneurs who manage established firms. These *liabilities of newness* arise from the following unique conditions.

liabilities of newness
Negative implications arising from an organization's newness

- New organizations face costs in learning new tasks. It may take some time and training to customize employees' skills to the new tasks they are asked to perform.
- As people are assigned to the roles of the new organization, there will be some overlap or gaps in responsibilities. This will often cause conflict until the boundaries around particular roles are more formally set (once management has gained sufficient knowledge to do so) and/or until they have been informally negotiated by the parties to the conflict.
- Communication within the organization occurs through both formal and informal channels. A new organization has not yet had the opportunity to develop informal structures, such as friendships and organizational culture. It takes time for a new firm to establish these informal structures.

Managing a new firm requires special attention to educating and training employees so that their knowledge and skills will develop quickly to meet the needs of their tasks, to facilitate conflicts over roles, and to foster social activities that will in turn quickly foster informal relationships and a functional corporate culture. If these liabilities of newness can be overcome, then the entrepreneur can benefit from some *assets of newness*. These assets acknowledge the advantages that a new organization has over a mature one, particularly in environments that are changing.

assets of newness
Positive implications arising from an organization's newness

Although mature organizations have established routines, systems, and processes that increase the efficiency of their operations, these routines, systems, and processes can be a liability when there is a need for those firms to adapt to changes in their environment. Previous practices create a momentum along the same path, and redirection is difficult. Mature

firms also find it difficult to attain new knowledge because their thoughts are narrowed by what has been done in the past and what they are good at rather than by the external environment and what is needed.

In contrast, new firms find that their lack of established routines, systems, and processes means that they have a clean slate, which gives them learning advantages over older firms.[22] They do not need to unlearn old knowledge and old habits to learn new knowledge and create the new routines, systems, and processes that are more attuned with the changed environment.

A heightened ability to learn new knowledge represents an important source of competitive advantage that needs to be fostered by the entrepreneur. It is particularly advantageous in a continuously changing environment because the firm needs to incrementally build its strategy as it learns information while acting. Previous strategic planning will not be successful in such environments because the development of such an environment is not knowable in advance (unless the entrepreneur is extremely lucky).

Therefore, although entrepreneurs must be aware of, and manage, liabilities of newness, it is not all doom and gloom. Rather, new ventures have an important strategic advantage over their mature competitors, particularly in dynamic, changing environments. Entrepreneurs need to capitalize on these assets of newness by creating a learning organization that is flexible and able to accommodate this new knowledge in its future actions. This shifts the emphasis in understanding firm performance from a heavy reliance on strategic plans to greater emphasis on the strategic learning and flexibility of the entrepreneur and his or her management team.

IN REVIEW

SUMMARY

One of the essential acts of entrepreneurship is new entry—entry based on a new product, a new market, and/or a new organization. Entrepreneurial strategies represent the set of decisions, actions, and reactions that first generate, and then exploit over time, a new entry in a way that maximizes the benefits of newness and minimizes its costs. The creation of resource bundles is the basis for new entry opportunities. A resource bundle is created from the entrepreneur's market knowledge, technological knowledge, and other resources. The new entry has the potential of being a source of sustained superior firm performance if the resource bundle underlying the new entry is valuable, rare, and difficult for others to imitate. Therefore, those wishing to generate an innovation need to look to the unique experiences and knowledge within themselves and their team.

Having created a new resource combination, the entrepreneur needs to determine whether it is in fact valuable, rare, and inimitable by assessing whether this new product and/or new market is sufficiently attractive to be worth exploiting and then acting on that decision. The decision to exploit or not to exploit the new entry opportunity depends on whether the entrepreneur has what she or he believes to be sufficient information to make a decision and on whether the window is still open for this new entry opportunity. The entrepreneur's determination of sufficient information depends on the stock of information and the entrepreneur's level of comfort in making such a decision without perfect information.

Successful new entry requires that the entrepreneur's firm have an advantage over competitors. Entrepreneurs often claim that their competitive advantage arises from

being first to market. Being first can result in a number of advantages that can enhance performance, such as cost advantages, reduced competition, securing important sources of supply and distribution, obtaining a prime position in the market, and gaining expertise through early participation. But first movers do not always prosper, and in fact there are conditions that can push a first mover toward performance disadvantages, such as high instability of the environment surrounding the entry, a lack of ability among the management team to educate customers, and a lack of ability among the management team to erect barriers to entry and imitation to extend the firm's lead time.

A new entry involves considerable risk for the entrepreneur and his or her firm. This risk of downside loss is partly derived from the entrepreneur's uncertainties over market demand, technological development, and the actions of competitors. Strategies can be used to reduce some or all of these uncertainties and thereby reduce the risk of downside loss. Two such strategies are market scope and imitation. Scope is a choice by the entrepreneur about which customer groups to serve and how to serve them—for example, the choice between a narrow and a broad scope. Imitation involves copying the practices of other firms, whether those other firms are in the industry being entered or in related industries; for instance, "me too" and franchising are both imitation strategies.

Entrepreneurship also can involve the creation of a new organization. The creation of a new organization offers some challenges for entrepreneurs that are not faced by those who manage established firms. These challenges, referred to as liabilities of newness, reflect a new organization's higher costs of learning new tasks, increased conflict over newly created roles and responsibilities, and the lack of a well-developed informal communication network. However, new organizations also may have some assets of newness, the most important of which is an increased ability to learn new knowledge, which can provide an important strategic advantage over mature competitors, particularly in dynamic, changing environments.

RESEARCH TASKS

1. Choose three major inventions that have led to successful products. Who were the inventors? How did they invent the technology? Why do you believe they were the first to invent this technology?
2. Find three examples of firms that pioneered a new product in a new market and were able to achieve long-run success based on that entry. Find three examples of firms that were not the pioneers but entered later to eventually overtake the pioneer as market leader. In your opinion, why were the successful pioneers successful, and why were the unsuccessful ones unsuccessful?
3. What is the failure rate of all new businesses? What is the failure rate of all new franchises? What inferences can you make from these numbers?

CLASS DISCUSSION

1. Come up with five examples of firms that have used imitation as a way of reducing the risk of entry. What aspects of risk was imitation meant to reduce? Was it successful? What aspects of the firm were not generated by imitation, made the firm unique, and were a potential source of advantage over competitors?
2. Provide two examples of firms with a broad scope, two with a narrow scope, and two that started narrow and became broader over time.

3. Is it a waste of time to detail the firm's strategy in the business plan when the audience for that plan (e.g., venture capitalists) knows that things are not going to turn out as expected and, as a result, places considerable importance on the quality of the management team? Why not submit only the resumes of those in the management team? If you were a venture capitalist, would you want to see the business plan? How would you assess the quality of one management team relative to another?

SELECTED READINGS

Ardichvili, Alexander; Richard Cardozo; and Sourav Ray. (2003). A Theory of Entrepreneurial Opportunity Identification and Development. *Journal of Business Venturing*, vol. 18, no. 1, pp. 105–24.

This paper proposes a theory of the opportunity identification process. It identifies the entrepreneur's personality traits, social networks, and prior knowledge as antecedents of entrepreneurial alertness to business opportunities. Entrepreneurial alertness, in its turn, is a necessary condition for the success of the opportunity identification triad: recognition, development, and evaluation. A theoretical model, laws of interaction, a set of propositions, and suggestions for further research are provided.

Barney, Jay B. (2001). Resource-Based "Theories" of Competitive Advantage: A Ten-Year Retrospective on the Resource-Based View. *Journal of Management*, vol. 27, no. 6, pp. 643–751.

The resource-based view is discussed in terms of its positioning relative to three theoretical traditions: SCP-based theories of industry determinants of firm performance, neoclassical microeconomics, and evolutionary economics. It also discusses some of the empirical implications of each of these different resource-based theories.

Boulding, William; and Christen Markus. (2008). Disentangling Pioneering Cost Advantages and Disadvantages. *Marketing Science*, vol. 27, pp. 699–716.

In this paper, the authors empirically test three different sources of long-term pioneering cost advantage—experience curve effects, preemption of input factors, and preemption of ideal market space—and three different sources of pioneering cost disadvantage—imitation, vintage effects, and demand orientation. The complexity of their findings suggests that managers need to think carefully about their particular conditions before making assumptions about the cost and, therefore, profit implications of a pioneering strategy.

Bruton, Gary D.; and Yuri Rubanik. (2002). Resources of the Firm, Russian High-Technology Startups, and Firm Growth. *Journal of Business Venturing*, vol. 17, no. 6, pp. 553–77.

This study investigates the extent to which founding factors in Russia help high-technology firms to prosper. It was found that the team establishing the business mitigated the liability of newness. However, in contrast to the culture of the United States, the culture of Russia does not produce negative results if the founding team grows very large. Additionally, it was shown that firms that pursued more technological products and entered the market later performed best.

Erikson, Truls. (2002). Entrepreneurial Capital: The Emerging Venture's Most Important Asset and Competitive Advantage. *Journal of Business Venturing*, vol. 17, no. 3, pp. 275–91.

This study presents a parsimonious model of entrepreneurial capital, defined as a multiplicative function of entrepreneurial competence and entrepreneurial commitment. The presence of both entrepreneurial competence and commitment

lays the foundation for enterprise generation and performance. Inherent in this view on competence is the capacity to identify opportunities.

Fiol, C. Marlene; and Edward J. O'Connor. (2003). Waking Up! Mindfulness in the Face of Bandwagons. *Academy of Management Review*, vol. 28, no. 1, pp. 54–71.

This article models the interactions between mindfulness as a decision-maker characteristic and the decision-making context, and shows the impact of those interactions on managers' ability to discriminate in the face of bandwagons. The authors illustrate the framework by applying it to recent integration and disintegration bandwagon behaviors in the U.S. health care market.

Haynie, J. Michael; Dean A. Shepherd; and Jeffery S. McMullen. (2009). An Opportunity for Me? The Role of Resources in Opportunity Evaluation Decisions. *Journal of Management Studies*, vol. 46, no. 3, pp. 337–61.

The authors apply the prescriptions of the resource-based perspective to develop a model of entrepreneurial opportunity evaluation. They propose that opportunity evaluation decision policies are constructed as future-oriented, cognitive representations of "what will be," assuming one were to exploit the opportunity under evaluation. Their findings suggest that entrepreneurs are attracted to opportunities that are complementary to their existing knowledge resources; however, we also identify a set of opportunity-specific and firm-specific conditions that encourage entrepreneurs to pursue the acquisition and control of resources that are inconsistent with the existing, knowledge-based resources of the venture.

Keh, Hean T.; Maw Der Foo; and Boon C. Lim. (2002). Opportunity Evaluation under Risky Conditions: The Cognitive Processes of Entrepreneurs. *Entrepreneurship: Theory & Practice*, vol. 27, no. 2, pp. 125–49.

This study uses a cognitive approach to examine opportunity evaluation. It finds that illusion of control and belief in the law of small numbers are related to how entrepreneurs evaluate opportunities. The results also indicate that risk perception mediates opportunity evaluation.

Lévesque, Moren; and Dean A. Shepherd. (2004). Entrepreneurs' Choice of Entry Strategy in Emerging and Developed Markets. *Journal of Business Venturing*, vol. 19, no. 1, pp. 29–45.

From speculations over the differences between emerging and developed economies, the model offers a systematic way to determine the optimal entry strategy in terms of entry timing and level of mimicry. An implication of the model is that the cost/benefit ratio of using a high-mimicry entry strategy is lower for companies entering emerging economies than it is for companies entering developed economies.

Lichtenstein, Benyamin; G. Thomas Lumpkin; and Rodney Shrader. (2003). A Theory of Entrepreneurial Action. In J. Katz and D. A. Shepherd (eds.), *Advances in Entrepreneurship: Firm Emergence and Growth* (vol. 6). (Greenwich, CT: JAI Press).

This chapter categorizes the organizational learning literature into behavioral, cognitive, and action learning and suggests a number of ways in which new ventures could be more successful at learning than larger and older organizations. It also explores three entrepreneurial contexts in which learning might be particularly important and matches them to the categories of learning.

Lieberman, Marvin B.; and David B. Montgomery. (1998). First-Mover (Dis)advantages: Retrospective and Link with the Resource-Based View. *Strategic Management Journal*, vol. 19, no. 12, pp. 1111–26.

This article suggests that the resource-based view and first-mover advantage are related conceptual strategic planning frameworks that can benefit from closer linkage. It presents an evolution of the literature based on these concepts.

McEvily, Susan K.; and Bala Chakravarthy. (2002). The Persistence of Knowledge-Based Advantage: An Empirical Test for Product Performance and Technological Knowledge. *Strategic Management Journal*, vol. 23, no. 4, pp. 285–306.

The authors find that the complexity and tacitness of technological knowledge are useful for defending a firm's major product improvements from imitation, but not for protecting its minor improvements. The design specificity of technological knowledge delayed imitation of minor improvements in this study.

Robinson, William T.; and Sungwook Min. (2002). Is the First to Market the First to Fail? Empirical Evidence for Industrial Goods Businesses. *Journal of Marketing Research*, vol. 39, no. 1, pp. 120–29.

The main conclusion of this study is that the pioneer's temporary monopoly over the early followers plus its first-mover advantages typically offset the survival risks associated with market and technological uncertainties. These results are consistent with previous research in the sense that first-mover advantages that increase a pioneer's market share also help protect the pioneer from outright failure.

Teplensky, Jill D.; John R. Kimberly; Alan L. Hillman; and J. Stanford Schwartz. (1993). Scope, Timing and Strategic Adjustment in Emerging Markets: Manufacturer Strategies and the Case of MRI. *Strategic Management Journal*, vol. 14, pp. 505–27.

This study examines the realized strategies of domestic manufacturers in a growing, high-technological industrial market in the United States. It offers a typology of entry strategies focusing on issues of timing and scope and on the impact that these entry strategies have on a firm's performance.

Ucbasaran, Deniz; Mike Wright; Paul Westhead; and Lowell W. Busenitz. (2003). The Impact of Entrepreneurial Experience on Opportunity Identification and Exploitation: Habitual and Novice Entrepreneurs. In J. Katz and D. A. Shepherd (eds.), *Advances in Entrepreneurship: Firm Emergence and Growth* (vol. 6). (Greenwich, CT: JAI Press).

This paper synthesizes human capital and cognitive perspectives to highlight behavioral differences between habitual and novice entrepreneurs. Issues related to opportunity identification and information search as well as opportunity exploitation and learning are discussed.

Watson, Warren; Wayne Stewart, Jr.; and Anat BarNir. (2003). The Effects of Human Capital, Organizational Demography, and Interpersonal Processes on Venture Partner Perceptions of Firm Profit and Growth. *Journal of Business Venturing*, vol. 18, no. 2, pp. 145–65.

This study examines the effects of human capital, organizational demography, and interpersonal processes on partner evaluations of venture performance, defined as the presence of profit and growth. The results support this approach in analyzing venture teams, and it is proposed that this perspective be included in future venture viability assessment and used for intervention to enhance venture success.

Zahra, Shaker A.; Donald O. Neubaum; and Galal M. El-Hagrassey. (2002). Competitive Analysis and New Venture Performance: Understanding the Impact of Strategic Uncertainty and Venture Origin. *Entrepreneurship: Theory & Practice*, vol. 27, no. 1, pp. 1–29.

Using survey data from 228 new ventures, this study concludes that the formality, comprehensiveness, and user orientation of competitor analysis activities are positively associated with new venture performance. Strategic uncertainty and venture origin also significantly moderate the relationship between competitive analysis and new venture performance.

END NOTES

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