# The Entrepreneurial Dilemma in the Life Cycle of the Small Firm

Theoretical Background of Entrepreneurship

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Chapter 1

# Theoretical Background of Entrepreneurship

This chapter introduces the basic theoretical features of entrepreneurship and forms the theoretical backbone of this book. These basic theoretical features of entrepreneurship are important to understand the phenomenon of entrepreneurship that plays a crucial role in the development of the small firm, and they are necessary for the development of entrepreneurship education (see Chapter 2 in this book) and for solving the entrepreneurial dilemmas (see Chapter 3 in this book). Eleven basic features of entrepreneurship are distinguished, all presented in different sections. Two sections also contain two subsections, respectively.

The first section (1.1) of this first chapter pays attention to the main definition of entrepreneurship that is used in this book and its five distinguished elements (i.e., creation, discovery, exploitation, value-adding, and opportunities). Then follow two phenomena that are of crucial interest for entrepreneurship nowadays, viz. innovation (Section 1.2) and sustainable entrepreneurship (Section 1.3). In the fourth section of this chapter, the main characteristics of small businesses are dealt with, as the main focus of this book is on the role of entrepreneurship in small businesses, both quantitative characteristics (Section 1.4.1) and qualitative characteristics (Section 1.4.2). In Section 1.5, the different stages in the development of small businesses are dealt with, with a number of alternative approaches in distinguishing different development stages for small businesses during the life cycle of the firm. Special attention is also paid to the protection of the firm (Section 1.5.1) and the exit strategy of the firm (Section 1.5.2), as these two aspects play a crucial role in this context. This section is followed by the subject of different types of entrepreneurs (including types of entrepreneurs outside the small businesses domain) in Section 1.6. The next section (1.7) is focused on the different roles that an entrepreneur can play within his business (which is in this section also explicitly connected to the different stages in the development of small businesses from Section 1.5). Section 1.8 deals with the 16 main entrepreneurial competences that can be distinguished, in order to be successful as an entrepreneur. The ninth section of this chapter is about entrepreneurial motivation, mainly to be distinguished between opportunity-driven (pull) and necessity-driven (push). The focus of the tenth section is on entrepreneurial behavior, with attention for the three most important models nowadays, viz. discovery and creation, causation and effectuation, and entrepreneurial orientation. The final section (1.11) of this chapter is about the so-called root of all evil: finance, viz. the different forms of financing the small business. All sections are provided with a limited number of additional and suggested readings on the subject.

## 1.1. Entrepreneurship

*The first subject in this section is the historical background of the thinking in the field of entrepreneurship, from the eighteenth century until the 1930s. Additionally, the definition of entrepreneurship that is used in this book is discussed, with its five different elements: creation, discovery, exploitation, value-adding, and opportunities.*

The theoretical positioning of entrepreneurship can be traced back to (at least) the eighteenth century, although entrepreneurs have existed much longer, they even in a sense have existed ever since the beginning of mankind. In order to survive, the first humans were already busy with the creation, discovery, and exploitation of value-adding opportunities, alone or in an informal or organized group.

However, it is commonly accepted that one of the first important publications in the field of entrepreneurship is *Essai sur la Nature du Commerce en Général*, in the French language, by Richard Cantillon (who lived from about 1685 until 1734), if not the first important publication. This book in the field of entrepreneurship saw its light in 1730 and is often abbreviated with the title "Essai." In this publication, the entrepreneur is mainly seen as the person who accepts the risks that are associated with uncertainty in the future, as he sees a profitable opportunity in this uncertain future. Although not much is known about the life and practice of Richard Cantillon, his personal background is often described as Irish-French: the Irish part may have to do with his country of birth whereas the French part may have to do with the fact that he was later in his life employed by the French government.

Another early writer in the field of entrepreneurship is Jean-Baptiste Say (1767−1832); he was (also) French, with his publication *Traité d'Economie Politique*, which appeared for the first time in 1803. In this publication, the entrepreneur is mainly seen as the coordinator in the production processes and in the distribution processes of goods. Say is also known for his law "supply creates its own demand" (Say's law is also called the law of markets).

In the following more than 200 years after Say, a great number of publications on entrepreneurship have emerged (and without any doubt, a great number of publications on entrepreneurship will follow in the future). Two developments are worth to mention here. The first publications were only on paper, whereas nowadays the publications are more and more digital and online. Next, the first publications mainly concerned books, later the publications also concerned papers in scientific journals, and later even papers in journals solely focused on the subject of entrepreneurship. International publishers have obtained a strong position in the market of publications on entrepreneurship.

Still, one of the most important and influential scientists in the context of entrepreneurship is Joseph Alois Schumpeter (1883−1950), who focused on (among others) the relationship between entrepreneurship and innovation. In Section 1.2, more attention is paid to the focal subject of the works of Joseph Schumpeter (who was born in Austria-Hungary and moved to the United States on a later age, in the 1930s), especially from the perspective of innovation.

In all these years of publications in the field of entrepreneurship, consensus on the definition has always been far away, and this consensus is still far away, and most probably this consensus will never be reached. There is an overwhelming multitude of definitions of entrepreneurship available nowadays, and without any doubt this pile will even grow further in the coming years. In the *Oxford Dictionary*, the meaning of the word entrepreneurship is not specifically described but only mentioned under the heading of the word entrepreneur, next to the word entrepreneurial. As already mentioned in the "Introduction" in this book, the meaning of the word "entrepreneur" is described by the *Oxford Dictionary* as "a person who starts or organizes a commercial enterprise, especially one involving financial risk." Related to this noun is the adjective "entrepreneurial," for which the next examples were given by the *Oxford Dictionary*: (1) entrepreneurial flair/skills/spirit and (2) some investors have become more entrepreneurial. This description of the word "entrepreneurship" in the *Oxford Dictionary* has a more or less tautological character, as the related word "enterprise" is part of the description of the word "entrepreneur." The four meanings of the word "enterprise" given in the *Oxford Dictionary* are, however, rather revealing: (1) a project or an activity, especially one that is difficult or requires effort, (2) the ability, imagination and desire to create or carry out new projects or activities, (3) business activity developed and managed by individuals rather than the state, and (4) a business company or firm. Although much can be brought against these descriptions in the field of entrepreneurship, the third meaning of the word "enterprise" here comes closest to what is understood with entrepreneurship in this book, especially through the elements "business activity" and "individuals." However, also the state may start and develop its own business activities and the concept of ownership is neglected in this third meaning of the word "enterprise."

The basics of the word "entrepreneur" go back to the French verb "entreprendre," which is translated to the English language as "to undertake," "to launch" or "to begin" (see www.dictionnaire.reverso.net). The word "entrepreneur" is by the same source translated as "contractor." This is quite strange, as the *Oxford Dictionary* describes "contractor" as "a person or firm that does jobs or provides goods of services under contract." Although a person who does jobs or who provides services under contract sounds very much like what can now be interpreted as an entrepreneur, indicating an entrepreneur as just a contractor is much too limited, as an entrepreneur is considerably more than just a contractor. When the translation is made in the opposite way, from English to French, "entrepreneur" translates identically as "entrepreneur" (www.dictionnaire.reverso.net). However, the English word "entrepreneurship" is translated to French as "*esprit d'enterprise*," which means as much as "spirit of enterprise." All in all, the strict translation of entrepreneurship does not bring us much further, which is an important reason to make a broader interpretation of entrepreneurship. The link to the French language, however, is logical, given the facts that one of the first publications in the field of entrepreneurship was by somebody with a partly French background (Richard Cantillon) and that another early important writer in the field of entrepreneurship was (also) French (Jean-Baptiste Say). Both seminal books were also written in French. However, nowadays, the literature in the field of entrepreneurship is most often in the English language, although within any country or language area, literature, and other materials in the own language may exist.

In this book, the definition of entrepreneurship that is used sounds: *the creation, discovery, and exploitation of value-adding opportunities*. This definition is self-developed by the author of this book and is partially based on the overwhelming number of definitions of entrepreneurship that are available all over the world, on the one hand, and many years of working in the academic field of entrepreneurship education and entrepreneurship research by the author of this book, on the other. The origins of this definition go back to 2009 (and even further back), when the early definition of entrepreneurship was formulated by the author of this book as follows: "entrepreneurship is concerned with the (creation) discovery and exploitation of profitable opportunities." This early definition of entrepreneurship was importantly based on the seminal work by Shane and Venkataraman (2000), in which they phrased entrepreneurship as "the existence, discovery, and exploitation of entrepreneurial opportunities." After a period of time, this early definition became unsatisfactory to the author of this book and, after a few steps in-between, the early definition was changed into the current main definition of entrepreneurship, as phrased at the beginning of this paragraph. A full place, without brackets, was given to "creation," as it emphasized the dynamic aspect of entrepreneurship. This addition was much inspired on the difference between discovery theory and creation theory, as distinguished by Alvarez and Barney (2007) in their seminal work, see Section 1.10 in this chapter. The major change in the early definition of entrepreneurship, however, was to replace the word "profitable" with the word "value-adding," as the orientation of the author of this book is very much on sustainable entrepreneurship, in which looking for a balance between economic value, social value and ecological value plays a key role, next to leading the organization (see also Section 1.3 in this chapter). So, the main definition of entrepreneurship in this book clearly holds these five elements: creation, discovery, exploitation, value-adding, and opportunities. All these five elements will be explained in the remainder of this section.

Creation stands for the process of going from nothing to something, or, more pragmatically, the process of going from something less to something more. In this respect, entrepreneurship clearly connects to innovation. Greatly based on the earlier mentioned seminal work by Schumpeter (1934), six forms of innovation can be distinguished: new products and services, new production processes, new markets, new inputs, new organizations, and new brands. The main addition of the author of this book to Schumpeter's works is the addition of "and services" to "new products" and the addition of new brands to the old list of five forms of innovation. The addition of "and services" to "new products" is quite obvious, as services can be seen as intangible products as well, and also given the increasing role of services in economic development since the launch of Schumpeter's seminal work. The addition of new brands to this list of innovation forms is more controversial. However, as brands contribute to the creation of customer value, according to the author of this book, it is a rather actual addition to Schumpeter's list of innovation forms. Remember that Schumpeter launched his seminal work more than 75 years ago and that in the meantime the society has changed dramatically. See Section 1.2 of this book for more information about the relationship between entrepreneurship and innovation.

The second element in the definition of entrepreneurship (viz. discovery) means bringing in something that already existed or applying something that already existed in a new context. One of best metaphors in this context is the discovery of America by Christopher Columbus (although he presumed that he had entered the Indies, but it appeared to be what was later called America); the newly discovered continent of America [...] already existed, even for a long time, but it was only brought into the global system (which was dominated by Europe in those days) after its discovery. In a certain sense, an application of something that already existed took place in a new context. More recently, the increasing use of the internet and social media by senior citizens can be pointed at, as an example of discovery, as the elderly formed one of the demographic groups that were lagging behind in the use of internet and social media, compared with the younger people, whereas in principle the elderly use internet and social media in the same way as the younger people do. The growing number of elderly even forms an interesting market for entrepreneurs. So, discovery has more or less to do with incremental innovations, based on existing points of departure, whereas previous mentioned creation has more to do with radical innovations, closer to a start from scratch. The distinction between incremental innovations and radical innovations (and more) will be dealt with in the next section of this book.

The third element in the definition of entrepreneurship that is used in this book, viz. exploitation, in this context means extracting value from the entrepreneurial idea (and what value is, will be dealt with in the next paragraph). Exploitation, thus, makes the entrepreneurial idea more worth and/or more useful. Between an entrepreneurial idea, on the one hand, and the final market success, on the other, lies to the so-called valley of entrepreneurial death. Many promising entrepreneurial ideas fail to reach the market in the end and they drop prematurely in this valley of entrepreneurial death, as proverbial prey for the vultures and only bleached skulls are left, under a burning sun. Only a limited number of entrepreneurial ideas will successfully reach the market in the end. Proper preparation of entrepreneurial activities and ditto business planning clearly contribute to bridging this gap, surviving the valley of entrepreneurial death, and eventually achieving entrepreneurial success. In other words, creation and discovery alone are not enough for entrepreneurial success; exploitation is indispensable for entrepreneurial success as well.

Value-adding is the fourth element of the definition of entrepreneurship that is used in this book. The concept of value can be seen as worth or usefulness. More specifically, in entrepreneurship, value may take three subforms: economic value, social value, and ecological value. Here, we see the Triple P bottom line (or the profit-people-planet concept), as economic value stands for Profit (and issues like labor productivity), social value stands for People (and especially their well-being), and ecological value stands for Planet (with special focus on environmental caretaking). In this book, the term sustainable entrepreneurship is used, defined as leading the firm by balancing between economic value, social value, and ecological value, see also Section 1.3 in this book. One of the most intriguing issues in this Triple P approach is to bring all three subforms under the same general denominator of value. This bringing together leads to bold statements about, for example, the value of human life in terms of money or in terms of trees. Section 1.3 further elaborates on this issue.

Finally, the fifth element in the definition of entrepreneurship that is used in this book, viz. opportunities, can be in short summarized as favorable circumstances. In the entrepreneurship literature, it is common to distinguish between opportunity discovery (mostly indicated as opportunity identification, so the opportunity is already there), opportunity creation (so, dealing with a new opportunity), and opportunity exploitation (how to extract value from the opportunity that was either discovered or created). So, the steps from opportunity identification and opportunity creation to opportunity exploitation are also connected to the steps from discovery and creation respectively, on the one hand, and value exploitation, on the other. Another intriguing discussion is whether opportunities are just out there, waiting to be exploited by for the entrepreneur, or that opportunities have to be created by the entrepreneur, and otherwise they will remain latent. This is closely related to the distinction between discovery theory and creation theory, see Alvarez and Barney (2007).



## Readings Section 1.1

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## 1.2. Innovation

*The first subject in this section is the definition of innovation that is used in this book: the successful market introduction of something new. Then, the focus is on the different forms of innovation: products and services, production processes, markets, inputs, organizational forms and brands. Finally, the subject of open innovation and entrepreneurial ecosystems are dealt with.*

In this book, innovation is defined as the successful market introduction of something new. This definition is based on two pillars: "successful market introduction" and "something new." The first pillar of the definition of innovation in this book can be described as the actual adoption by buyers and/or users, at the other side of the market. In line with the approach of newness in the remainder of this section, the market may be internal (within the firm) or external (local, regional, national, or international). The adverb "successful," to market introduction, in this definition of innovation means that there is an actual willingness to buy the innovation and/or to use it. The buyers of the innovation may be the users as well, or they are the intermediaries who sell the innovations to the respective users, possibly in an adjusted form (or to other intermediaries, who sell, in their place, the innovations, again possibly in an adjusted form, to the users, or again to other intermediaries who sell it upstream in the direction of the users, etc.).

The second pillar of the definition of innovation in this book is "something new." The innovation, which is adopted by the market, is by definition preceded by the invention that is basically the "something new" part of this definition of innovation, and even earlier by the development of the idea, that has led to the invention. "New" is a stretchy concept: it can be novice internal (within the firm) or novice external (local, regional, national, or international). The main issue with defining the concept of new in the context of innovation is: new to whom or new to what? Is the invention new to the entrepreneur, new to the firm, new to the sector, new to the region or new to the country in which the firm operates, or even new to the world, so completely new? And how should something new be interpreted when an innovation takes place on different places but in the same period?

The ancient art of printing is one specific example of how the discussion on the concept of new may take place. Concerning the use of the invention of printing, there is internationally, at least in the Western world, more or less consensus that Johannes Gutenberg (who lived from about 1398 until 1468; his full name was Johannes Gensleisch zur Laden zum Gutenberg) from Mainz (currently in Germany) is the inventor of the art of printing. However, the invention of the art of printing is also coined to the Dutch Laurens Jansz. Coster (who lived from about 1370 until 1440) from Haarlem (currently in the Netherlands), especially by some Dutch people. However, in principle, it is possible that inventions are developed at more than one place in the same period and the same counts for the transformation of the invention to the innovation. In earlier days, note that we are talking with above invention of printing about the fifteenth century, geographic distinct areas were much more isolated than they are today. Hence, it is very well possible, even quiet probable, that Johannes Gutenberg and Laurens Jansz. Coster had never heard about each other and that they never knew that the other one was also involved with the invention of the art of printing and annex the successful introduction of the art of printing to the market. However, the invention of the art of printing is also coined to Chinese people, even far before the fifteenth century, so long before Johannes Gutenberg and Laurens Jansz. Coster were born. Apparently, this invention had never disseminated from Asia to Europe, where Johannes Gutenberg and Laurens Jansz. Coster were operating with their printing processes. Asia and Europe were more or less two closed worlds and not connected to each other in those days, considerably more closed to each other than they are nowadays.

As said, different levels of newness can be distinguished: is the innovation new to the firm, is the innovation new to the region in which the firm operates, is the innovation new to the country in which the firm operates, or is the innovation even new the world? To this hierarchy, in principle, new to the universe may be added as well. There is a hierarchy in this summing up: if the innovation is new to the world, then it is by definition new to the country in which the firm operates as well, and if the innovation is new to the country in which the firm operates, then it is by definition new to the region in which the firm operates as well. And if the innovation is new to the region in which the firm operates, then it is by definition new to the firm as well. However, this reasoning cannot be reversed: if the innovation is new to the firm, then it is not necessarily new to the region in which the firm operates, and thus not necessarily new to the country in which the firm operates and neither necessarily new to the world. If the innovation is new to the region in which the firm operates, then it may not be new to the country in which the firm operates, let go new to the world. And if the innovation is new to the country, then it is not necessarily new to the world.

Another way of looking at the newness of the innovation is the distinction between radical new and incremental new. Radical new in this context means disruptive, that is, not comparable to anything known before. Incremental new in this context means that the innovation is somehow related to one or more predecessors and as such that the innovation is not completely new. One example of an incremental innovation is the recent iPhone X (10). Basically, there is not so much really new with the iPhone X, there are not many attributes with the iPhone X that were not yet available with the iPhone 7 (its main predecessor). The major improvements of the iPhone X are its screen, its speed, and its protective case, and these improvements make the iPhone X unique (that is, until its successor will be launched). This new combination of features in the iPhone X as such can be seen as radical, because this combination was not presented before. However, when looked at the functions that are fulfilled by the iPhone X, the device cannot be characterized as radical new, as it cannot been judged as disruptive. The common proposition of the author of this book is even that in general hardly any innovation or even not a single innovation at all is really new. So basically, all innovations are variations on a theme, so to say, and it is more a matter of the degree into which an innovation is radical or incremental.

Although the common image of innovation is predominantly a new product, many other forms of innovation can be distinguished as well. In general, six different forms of innovations can be distinguished:

(1) new products and services (e.g., the Apple watch, launched in 2014, or the now common phenomenon of pizza delivery that was not commonly known before the 1980s);
(2) new production processes (e.g., internet banking, developed at the end of the twentieth century);
(3) new markets (e.g., the senior citizen market: this market has gradually developed and will even grow further as long as people tend to get older);
(4) new inputs (e.g., nuclear power, launched in the decades after the World War II);
(5) new organizational forms (e.g., social entrepreneurship, that became real popular in the second decade of the twenty-first century); and
(6) new brands (e.g., Nike, founded in 1962).

The first five forms of innovation go back to as far as the works of Joseph Schumpeter (his works stem mainly from the 1930s), although services were added to products by the author of this book, as services can be seen as intangible products as well. The sixth form of innovation was also added by the author of this book, to the sequence of Schumpeter (1934), as new brands may create a surplus of consumer value, because they are unique in the eyes of the customer. Note that not all forms of innovation have a non-ambiguous date of introduction. For example, the Apple watch has a more or less clear date of start, with the announcement in April 2014 at Apple's annual World Wide Developers Conference (although the actual sales only started in May 2015). However, the dates of the introduction of pizza delivery, internet banking, and nuclear power are fuzzy: nobody exactly knows when they first entered the market.

Recently, the concept of frugal innovation has become more in vogue. The main theme with frugal innovation is to reduce the complexity of a product (e.g., by removing one or more non-essential features) and thus limit the costs of products. Obviously, frugal innovations are embraced by especially the population of low income countries. One example of frugal innovation is the widespread use of M-Pesa in Kenya and Tanzania, launched by the provider Safaricom: this form of mobile banking allows people to access basic banking services from their mobile phones. Interestingly, M-Pesa can be used by applying an app on the smart phone but it can also be used on the good old Nokia phone. Another example of frugal innovation is the Tata Nano car, one of the cheapest cars in the world, if not the cheapest. The Tata Nano car is sold mainly in India.

Currently, when discussing the phenomenon of innovation, there is ample attention for open innovation and for the Triple Helix concept (although the latter phenomenon is already rather dated). In short, open innovation means that innovation is not a closed process by one organization only but that innovation requires collaboration with other organizations, in temporary coalitions, in the pursuit of success. This collaboration among organizations has to do with different fields of operation, for example, human resources management, procurement, marketing, and intellectual property (IP). One seminal work in the field of open innovation is "The Era of Open Innovation" by Chesbrough (2003). This form of collaboration in the field of innovation does not necessarily apply to the integral production and distribution process (or value chain) but this collaboration can also apply to one stage or part or a number of stages or parts in the value chain only.

Wynarczyk, Piperopoulus, and McAdam (2013) identified four pillars on which the concept of open innovations rests: user innovation, which states that a great part of innovations are in fact co-developed with the end-users; regimes of appropriation,[1] which is about the efficiency and the effectiveness of the legal mechanisms of protection (or IP rights); absorptive capacity, which is about the ability to recognize the value of new information and to apply this for commercial purposes; and strategic alliances, which states that collaborations provide the necessary innovative capacities, especially for small-scaled firms, because they lack economies of scale, and collaboration with other organizations may compensate for this resource poverty.

Another term that is relevant in the modern vision on innovation is the Triple Helix concept, which means, in short, that collaboration between the public sector, the private sector, and the knowledge sector is indispensable for the aim to be successful in innovation. The basic assumption behind the Triple Helix concept is that the three sectors play different but complementary roles when it comes to innovation. See among others Leydesdorff and Meyer (2006) who even translate the three sectors into control (public sector or government), wealth generation (private sector or firms), and novelty production (knowledge sector or universities). One good example of the Triple Helix concept is the Technology Transfer Offices (TTOs) at Dutch universities (but these offices are present in other countries as well) that could be opened with the help of national and/or regional subsidies. At these offices, scientists are supported by business developers and legal experts to bring their knowledge to the market or at least in the direction of the market, for example, in the form of a spin-off company or with the protection of a patent, and often with the help of external coaches from the private sector (e.g., university alumni). Here, we see a typical collaboration between the public sector (the national government or the regional government with their subsidies), the private sector (the spin-off company and the external coach), and the knowledge sector (the scientist who develops his academic knowledge toward the market).

One other term that is also often used in the modern vision on innovation is ecosystem. This term is borrowed from biological sciences. In the *Oxford Dictionary*, ecosystem is described as "all the plants and living creatures in a

[1]In the original text in the chapter by Wynarczyk et al. (2013), the term appropriability was used but the term appropriation is a better term in the eyes of the author of this book.

particular area considered together with their physical environment." Freely translated to the innovation context, the innovation ecosystem can be seen as the whole set of players that are relevant for the innovation performance in a certain physical area (e.g., a country, a region or a city). Although all the actors, almost by definition, belong either to the public sector, the private sector or the knowledge sector, or a combination of two or three of these sectors, in the ecosystem approach, there is more room to elaborate on the individual players and not so much the on aggregated sectors. Related terms to the innovation ecosystem are the entrepreneurial ecosystem (with focus on the development of entrepreneurship in a certain physical area) and the start-up ecosystem (with focus on the development of start-ups in a certain physical area). Note that the three ecosystem-related terms are often even used interchangeable and that they overlap to an important extent.

Stangler and Bell-Masterson (2015) proposed four indicators that signal (or measure) the entrepreneurial ecosystem vibrancy or strength in a certain region: density, fluidity, connectivity, and diversity. Below follows an explication how to operationalize and to measure these four indicators on the vibrancy of an entrepreneurial ecosystem. This overview is freely based on the work by the two previously mentioned authors. The four indicators can also be used to benchmark two or more entrepreneurial ecosystems with each other and to learn from each other.

The first indicator of the entrepreneurial ecosystem vibrancy in a certain region is density or the quantitative relevance of entrepreneurship in the region. This density can be measured in a number of ways, for example, the number of start-ups in relation to the whole population in a certain period (e.g., the number of start-ups per 1,000 inhabitants in a certain year in that region), the share of employment created by the start-ups in a certain period (e.g., as a percentage of the total working population in a certain year in that region), and the relative number of start-ups in the tech sector (e.g., as a percentage of all firms in this sector in a certain year in that region). Although a typical all-purpose word, the tech sector is obvious for the measurement of density as indicator for the vibrancy of the entrepreneurial ecosystem, because of the multiplier effect that firms in this sector can exert over other kinds of firms (e.g., because the other firms play their roles as suppliers). The focus in these examples is on start-ups because they are important boosters of the innovation process, but firms from other stages during the life cycle of the firm could have been chosen as well, for example, scale-ups.

Fluidity, the second indicator of the entrepreneurial ecosystem vibrancy in a certain region, can be measured in terms of population influx to the region, especially high-skilled people (e.g., the number of university taught entrants divided by the total population in a certain age group); labor market reallocation within the region, again especially high-skilled people (e.g., the number of job shifts by university taught employees divided by the total population of university taught employees); and the relative number of high-growth firms (e.g., in a percentage of the total number of firms in the region). Again, it is important to determine a certain period, otherwise an indicator cannot really be distinguished. The focus of fluidity on high-skilled people is because they are often employed by tech companies. The focus on high-growth firms is because they often focus on and contribute to innovation.

Connectivity, the third indicator in the context of the entrepreneurial ecosystem vibrancy in a certain region and in a certain period, can be measured in terms of the degree into which programs for entrepreneurs are linked (e.g., combining the fields of education and finance); the spin-off rate (e.g., the generation of new spin-off companies by existing companies or by universities); and the strength of dealmaker networks (e.g., the extent to which these networks meet the expectations of the participants). The first and the third subindicators here urge more qualitative judgments, like the level of the programs and the level of the dealmaker networks. The second subindicator can be properly measured in quantitative terms, like the number of spin-offs divided by the size of employment of the existing companies or universities.

Finally, diversity in the context of the entrepreneurial ecosystem vibrancy in a certain region can be measured in terms of the number of its multiple economic specializations or sectors, the immigrant share of the population (which indirectly refers to the works on the creative class by Richard Florida), and the upward mobility on the labor market (in terms of the probability of moving up on the economic ladder). However, diversity as such seems to be more a determinant of the entrepreneurial ecosystem vibrancy of a certain region rather than an indicator of entrepreneurial ecosystem vibrancy as such.

## Readings Section 1.2


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## 1.3. Sustainable Entrepreneurship

*The first subject in this section is the definition of sustainable entrepreneurship: leading the organization by making balanced choices between profit, people, and planet. Additionally, a number of milestones in the development of sustainable entrepreneurship are dealt with. Finally, the focus is on the motivation of the entrepreneur to deal with sustainable entrepreneurship and on the relationship between sustainable entrepreneurship and profitability of the firm.*

Concerning the subject of this section, that is, sustainable entrepreneurship, a number of related terms can be distinguished. The term that comes closest to sustainable entrepreneurship is corporate social responsibility (CSR). This latter term also more or less preceded the term sustainable entrepreneurship in time. Nevertheless, the term sustainable entrepreneurship is preferred in this book, above the term CSR, because this term fits better with small businesses (in which entrepreneurs, those people who are exercising entrepreneurship, play a crucial role, see also Section 1.4.2 in this book), whereas the term CSR is more used for and by large firms (among them multinational firms). In principle, each language also has its own term for sustainable entrepreneurship annex CSR.

Sustainable entrepreneurship is defined by the author of this book as "leading the organization by making balanced choices between profit, people, and planet." This definition can also be rephrased into "leading the organization by making balanced choices between economic aspects, social aspects, and ecological aspects of the firm." So the balancing between profit, people, and planet is not without obligations, as the aspect of leading the organization (and continuity of the firm) should also be taken into account. Further, according to the author of this book, sustainable entrepreneurship goes beyond rules and regulation, so sustainable entrepreneurship is by definition voluntary in nature. However, there may be a gray zone where it is not clear whether specific rules and regulations apply, for example, when the environment is changing rapidly or when doing international business.

The concept of sustainable entrepreneurship is based on two pillars: entrepreneurship and sustainable development. The phenomenon entrepreneurship has been dealt with extensively in Section 1.1 of this chapter and is defined as the creation, discovery, and exploitation of value-adding opportunities. Note that the adverb value-adding clearly opens the door for the use of the term sustainable entrepreneurship, because, as we will later see in this section, the adjective sustainable in combination with entrepreneurship points at three forms of value: economic value, social value, and ecological value.

The term sustainable development was most prominently introduced by the so-called Brundtland committee (officially mentioned the World Commission on Environment and Development), called after its chairwoman Gro Harlem Brundtland, former Prime Minister of Norway, in its report "Our common future." Sustainable development was defined in that report as "meets the needs of the present without compromising the ability of future generations to meet their own needs" (World Commission on Environment and Development, 1987, p. 41). In other and more popular words, sustainable entrepreneurship can be in short worded as follows: take care of the present without neglecting the future (or take care of the future without neglecting the present), or leave something of the world behind for the people who come after you. The year in which the definition of the Brundtland Committee was coined (1987) can be seen as the starting point of the modern thinking in the field of sustainable development. Some modest attention by the Brundtland Committee in this context was paid to "small- and medium-scale enterprises," especially to their information need, required financial and technical assistance from the public sector, and needed human resource training. Also, cooperative efforts among smaller firms in joint research and development on environmental issues, for example, or joint use of pollution control or waste treatment facilities, were encouraged.

This is not exactly the place to deal with all kind of predecessors of sustainable development, as this is not a book on history, but it should be noted that there have been many predecessors of sustainable development before 1987. In particular, the Bible and the Koran can be seen as pivotal documents for the thinking in the field of sustainable development. Both in the Bible and in the Koran, stewardship of people for the physical world and care for others are promoted. Somewhere between the Bible and the Koran, on the one hand, and the Brundtland committee, on the other hand, the philosopher (and more) Thomas of Aquino (1225−1274) can be placed, with his just price and his plea against usury, also an important document in the field of sustainable development.

Another important milestone in the modern thinking in sustainable entrepreneurship has been the work in the second half of the 1990s by John Elkington, on the Triple P bottom line approach. With this work he drew attention for the combination of economic performance, social performance and ecological performance of firms. He already indicated that, in those days, there were many definitions and many approaches in the field of sustainability. More recently, he came up with another approach in the field of sustainable entrepreneurship, viz. the so-called Zeronauts and breaking the sustainability barrier (Elkington, 2012). In the context of this book, a Zeronaut can be seen as an entrepreneur who aims to create wealth while driving non-favorable environmental, social and economic impacts toward zero levels. Five stages in the development of entrepreneurs were distinguished by Elkington:

(1) Eureka!, the stage in which the entrepreneurs see the opportunities for developing as Zeronauts;
(2) experimentation, the stage in which the entrepreneurs explore new ways of doing business;
(3) enterprise, the stage in which the entrepreneurs create new business models;
(4) ecosystem, the stage in which the entrepreneurs develop new markets; and
(5) economy, the stage in which the entrepreneurs flip the economic system to a more sustainable state.

Communication and sustainable entrepreneurship is a fascinating duo. On the one hand, entrepreneurs can be identified who are very active in the field of sustainable entrepreneurship but who do not or hardly communicate this to the outside world. Possible explanations for this poor communication can be modesty of the entrepreneur, underestimation by the entrepreneur of the effects that proper communication may have and incapability of the entrepreneur to communicate well in this respect. On the other hand, entrepreneurs can be identified who are not or who are hardly active in the field of sustainable entrepreneurship but who communicate to the outside world that they are very active in this field. This phenomenon is called green washing: the practice of firms to present their products, services, and policies as sustainable while they are not, or as more sustainable then they actually are, also known as window dressing.

There are at least two more intriguing issues when dealing with sustainable entrepreneurship by small businesses. The first issue concerns the motivation of an entrepreneur to engage with his business in sustainable entrepreneurship. The other issue is partly connected to previous issue and sounds: is sustainable entrepreneurship profitable or loss-making (or even neutral) for small businesses?

Concerning the first issue, the motivation of the entrepreneur to undertake activities in general can be judged in terms of pull factors and push factors, in terms of financial incentives and non-financial incentives and in terms of intrinsic motivation and extrinsic motivation (all given external constraints). With external constraints, it is meant that an entrepreneur is not always fully free to do what he really wants to do. These external constraints can be distinguished by personal circumstances (e.g., available time and cognition of the entrepreneur), firm characteristics (e.g., the location and the market reach of the firm), and environmental or external reasons (e.g., legal rules and other regulations the firm has to comply with). Nevertheless, any entrepreneur has at least a certain personal space for acting, to be filled in by himself, in which he is free to do what he wants to do and not to do what he does not want to do. Then, entrepreneurial motivation comes in, being the reason why the entrepreneur acts likes he does. See also Section 1.9 in this book, for more information about entrepreneurial motivation.

In the context of sustainable entrepreneurship, and concerning entrepreneurial motivation, a distinction can be made between pull factors and push factors. This distinction is most commonly known from the start-up of firms (why do people start their own firms?), but it can also be applied to decisions made by the entrepreneur during the operations of the firm. Here, in this section, pull factors can be described as drivers that attract the entrepreneur into sustainable activities, because the entrepreneur thinks it will lead to personal benefits for him. Examples of these personal benefits are increasing wealth (e.g., the entrepreneur expects to become rich from sustainable activities in the future) and more personal happiness (e.g., the entrepreneur expects that sustainable activities will make him proud and will give him respect in his community). Push factors can here be described as drivers that put pressure on the entrepreneur to move away from his current situation and into a certain sustainable activity, because he expects to be better off in the other situation. Examples of push factors here are perceived future changes in environmental rules and regulation (that, e.g., make the entrepreneur anticipate when buying a new machine) and feared stigmatization of being not social and/or not environmentally friendly in his operations (that may, e.g., lead to a boycott of customers in the future).

Further, concerning entrepreneurial motivation, a distinction can be made between financial factors and non-financial factors. The entrepreneur may be motivated by a financial factor to make a certain decision in the field of sustainable entrepreneurship, for example, when he decides to buy a certain machine that uses less energy than its predecessor: this leads to both lower energy costs for the firm and to lower environmental pressure in general. However, this primary motivation by a financial factor may also end up in a better image of the firm when it comes to sustainability, because the firm has reduced its level of energy use. The financial motivation may also lead to the decision not to involve in a sustainable activity because it is too expensive, for example, buying an energy-efficient machine that is more expensive in total use than a machine that is not energy efficient. But the entrepreneur may also be motivated by a non-financial factor to make a certain decision, for example, when he decides to hire a disabled person from whom he knows that this person will not be as productive as a person who is not disabled, because in this way he wants to make a contribution to a better society. However, this primary motivation by a non-financial factor may also end up in extra clients and extra sales, because the firm's image has been improved by the hiring of a disabled person.

A distinction can also be made between intrinsic motivation and extrinsic motivation for sustainable decisions. Intrinsic motivation comes from the entrepreneur himself, for example, when he deliberately decides to trade with small-scale suppliers from developing countries (fair trade), because this feels right for him, although this trading may be more expensive than the alternative of working with supplying multinational corporations. Extrinsic motivation is borne from the outside, for example, when a pressure group in the field of human rights puts pressure on the entrepreneur not to trade with supplying multinational corporations but with small-scale suppliers from developing countries, in order to contribute to a more fair income of these small-scale suppliers.

Two more observations are important when it comes to entrepreneurial motivation and sustainable entrepreneurship. First, motivation is mostly, if not always, a combination of factors and not just a matter of only one factor. Second, different factors do not always, even do not often, exclude each other. So one or more pull factors and one or more push factors may come together when it comes to a certain entrepreneurial motivation. Also, one or more financial factors and one or more non-financial factors may come together when it comes to certain entrepreneurial motivation. Such a combination is also possible when it comes to intrinsic motivation and extrinsic motivation.

The motivation concerning involvement in sustainable entrepreneurship does not only apply to a yes or no situation (dummy) but this motivation may also have to do with the extent into which small business are engaged with sustainable entrepreneurship. In general, based on the research by Masurel and Rens (2015) in the Dutch construction sector, it can be stated that front-runners in the field of sustainable entrepreneurship are more motivated by pull factors than followers in the field of entrepreneurship are. Surprisingly, they also came to the conclusion that for both front-runners and followers pull factors are more important than push factors.

As said, another intriguing issue when dealing with sustainable entrepreneurship by small businesses is whether sustainable entrepreneurship is profitable or loss-making. It can be hypothesized that the economic performance of small businesses in general is positively correlated to the social engagement and/or ecological engagement of the firm. Hence, causality is not specified here: it is not stated whether the better economic performance of the firm leads to more social engagement and/or ecological engagement of the firm nor whether more social engagement and/or ecological engagement of the firm helps to achieve a better economic performance. The literature studied on this issue did not deliver any solid basis for presuming causality, in either direction. Note that more social engagement and/or ecological engagement of the firm is, in principle, a voluntary decision, made by the entrepreneur. Both positions in the causality discussion can be defended. For example, if a firm performs economically better than in a previous period, then an extra budget may come available for additional investments in voluntary social activities and/or ecological activities, and the entrepreneur is the main decision-maker for the additional investments. Another example, if a firm shows more voluntary social activities and/or ecological activities, so after the entrepreneur decided to take this course of action, then the stakeholders of the firm may become more positive toward the firm. One example of this causality is: (potential) clients may be more eager to buy products or services from a firm with a better social image and/or ecological image than its competitors, thus leading to a better economic performance of that firm. Another example is that employees may become more motivated if the firm is showing more social engagement and/or ecological engagement, hence leading to higher labor productivity and thus better economic firm performance. It is plausible to expect that both these causalities did, do, and will occur in practice: better economic firm performance may lead to more social engagement and/or ecological engagement of the firm, and, vice versa, more social engagement and/or ecological engagement of the firm may lead to better economic firm performance. This can be called an iterative relationship between the economic performance of the firm, on the one hand, and its social engagement and/or ecological engagement, on the other.

Decision-making in the context of sustainable entrepreneurship is often a complicated issue. One specific explanation for this complexity is the fact that economic value, social value, and ecological value do not have a generally accepted common denominator, even not money. One of the tools that may be helpful in this context is the Sustainable Entrepreneurship Balanced Scorecard, which is based on the original Balanced Scorecard from the beginning of the 1990s. Like the original Balanced Scorecard, the Sustainable Entrepreneurship is also rooted in the interaction between the firm and its external environment (especially its stakeholders). See also Appendix 5 in this book.

## Readings Section 1.3

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## 1.4. Characteristics of Small Businesses

*This section deals with the quantitative characteristics and the qualitative characteristics of small businesses. The quantitative characteristics have to do with firm size, in different regional contexts, mainly in terms of employment, but also sales, assets, and profits. Next, eight qualitative characteristics are distinguished: the prominent role of the entrepreneur, the focus on the short-term, the strong regional/local focus, the complicated performance measurement, the high prevalence of family businesses, the simple formal organograms, the low degree of formalization, and finally the great importance of umbrella organizations.*

In this book, small businesses are primarily identified as "non-large business." In that respect, we connect to the seminal paper by Welsh and White (1981), published more than 30 years ago in the *Harvard Business Review*, titled "A Small Business Is Not Little Big Business." The meaning of this striking title is that small businesses, by contrasting them with large businesses, are not only different in quantitative respect (or size), but they also show different qualitative characteristics. So small businesses are not just another type of businesses next to large businesses, but they are really different from each other. The focus in the paper by Welsh and White (1981) is on the resource poverty of small businesses, especially severe constraints on financial resources, lack of trained employees (especially in accounting and bookkeeping), and limited management perspective due to a volatile competitive environment. However, the generalization of the first focus area (severe constraints on financial resources) is questionable, as certain small businesses are known for their strong solvability, especially family businesses, and other small businesses (e.g., in the services sector) do not need so much finance. The second focus area (lack of trained employees, especially in accounting and bookkeeping) seems to be somewhat dated, as the development of the internet has increased greatly the access of small businesses to services in accounting and bookkeeping without the need to hire own personnel. Concerning the third focus area (limited management perspective due to the volatile environment), as small businesses may operate in a rather clear market niche, there is not automatically a problem with the environment. So, all in all, the title and the message of this chapter still hold for sure ("A Small Business Is Not a Little Big Business"), even the argument of resource poverty may hold in a certain perspective, but the message can be interpreted in a different way after all these years.

The qualifications small and large are by no means value judgments, they are just value-free observations of the size of the firm. And firm size is not more than an instantaneous photograph, as firms may grow in time (and firms may also shrink in time of course). Every firm has started small once, although it may be hard to comprehend that also Apple, Google, Microsoft, Amazon, and Facebook (the five largest firms in the world in 2017, in terms of stock exchange value) have once started small, with, for example, Apple starting to work from a garage in the early days and Facebook from a student room.

For the identification of small businesses, it can be looked at the quantitative characteristics and at the qualitative characteristics of these firms. The quantitative characteristics dealt with in Section 1.4.1 have to do with the size of the firm, and then the main questions are as follows: (1) which criteria are used to measure the firm size and (2) how are these criteria made operational. The qualitative characteristics dealt with in Section 1.4.2 have to do more with the behavior of the firm in practice.

### *1.4.1. Quantitative Characteristics*

*This section is about firm size, in different regional contexts, mainly in terms of employment, but also sales, assets, and profits.*

There is something strange with the use of the term small business. The term is often used as contrast to large or large-scaled business and that makes sense: small versus large is a logical contradiction. But the exact interpretation of the concept of "small" in small business varies strongly over the world and holds a lot of ambiguity.

In the United States of America (USA), there is not really a uniform way to identify small businesses in a national sense. Small businesses in the USA are defined numerically, that is, on the basis of their size, mostly in terms of annual receipts or number of employees (sometimes added by one or more extra criteria). This firm size should take a maximum, and that size standard represents the largest size that a business (including its subsidiaries and affiliates) may take to remain classified as a small business and thus still be eligible for government programs and preferences especially reserved for small businesses. The quantitative definition of small business varies by industry or subsector, for example, 200 employees for new car dealers and 25 million US Dollar (USD) for used car dealers. The general thought behind this approach is that a small business should not be dominant in the field of operation for which it is bidding on a government contract. In addition, a small business should be independently owned and operated, and not dominant in its field on a national basis. See www.sba.gov. All in all, 99.7% of all USA firms can be labeled as small (see www.forbes.com).

However, in the European Union (EU), the word small business is used as an everyday synonym for small and medium-sized enterprises (SMEs). SMEs in the EU are defined as those firms that have less than 250 employees (called staff head count, that is the number of employees in an organization according to the *Cambridge English Dictionary*), and either an annual turnover ceiling of 50 million euro or a balance sheet of not more than 43 million euro (see www.ec.europa.eu). The definition of an SME is important for access to finance and EU support programs targeted specifically at these enterprises. The whole group of SMEs is also defined to constitute of three subgroups: medium-sized enterprises, small enterprises, and micro enterprises. Medium-sized enterprises are defined as those firms that have between 50 and 250 employees, and either an annual turnover ceiling of between 10 and 50 million euro or a balance sheet of between 10 and 43 million euro. Small enterprises are defined as those firms that have between 10 and 50 employees, and either an annual turnover ceiling of between 2 and 10 million euro or a balance sheet of between 2 and 10 million euro. Finally, micro enterprises are defined as those firms that have less than 10 employees, and either an annual turnover ceiling of 2 million euro or a balance sheet of not more than 2 million euro. So the term small business is swallowed in the group of SMEs, that stands for medium-sized, small [...] and micro firms. All in all, SMEs represent 99% of all businesses in the EU.

Countries outside the USA and the EU often also have their own criteria to identify small businesses or SMEs. Take for example Tanzania: in this East African country, micro, small, and medium enterprises (MSMEs) are distinguished (see www.fortuneofafrica.com). Medium-sized enterprises have between 50 and 100 employees and have between 200 and 800 million Tanzanian Shillings invested in machinery; small enterprises have between five and 50 employees and have between five and 200 million Tanzanian Shillings invested in machinery; and micro enterprises have less than five employees and have less than five million Tanzanian Shillings invested in machinery.[2]

In Tanzania, and also in most other developing countries, a distinction between the informal sector and the formal sector is relevant. The difference between the formal sector and the informal sector starts with registration with certain business organizations (e.g., with the Business Registration and Licensing Agency (BRELA) in Tanzania). This registration may have far-reaching consequences, as registration also makes firms visible, for example, for tax collection purposes, and as firms from the informal sector (also called informal enterprises) are in general excluded from obtaining loans from the banking sector and micro finance institutions (MFIs). Generally speaking, the majority of micro enterprises operate in the informal sector, most of the small enterprises operate in the informal sector, most of the medium enterprises operate in the formal sector, and all large enterprises operate in the formal sector (although exceptions exist). In the Western world, there is as such no difference between the formal sector and the informal sector, as any firm in the Western world has to register with the Chamber of Commerce or a comparable organization. However, this does not imply that there are no non-formal enterprises in the Western world, for example, criminal organizations, but they are not part of the reflection on small businesses in this section. Next to that, firms in the Western world may operate partly in an informal way, for example, because of tax evasion, and thus operate in a gray zone, partly formal, partly informal.

Next to the standard small businesses and SMEs, also solo self-employed people (without employees) can be identified. They can work full-time or part-time (as any owner of a small business may do as well), and they can have a side job as well. The distinction between part-time and full-time as such is useful, although the full-time equivalent is not really a relevant measure for entrepreneurs, as they often do not work the employees' standard number of hours per week and as they are not restricted to a certain number of hours based on an employment contract. Next to that, smaller and larger part-time self-employed people without employees can be identified, for example, on the basis of the number of working hours per day or the number of working days per week.

However, there are at least two important issues with the measurement of employment with small businesses. First, it should be noted that it is misleading to focus only on the number of employees (salaried people), and not on the number of employed persons, including active owners and their no-paid active family members who are not on the payroll of the firm. In particular in the subgroup of

[2]In 2017, one USD was worth about 2,200 Tanzanian Shillings. This exchange rate implicates that medium-sized enterprises have invested about 90,000 to 350,000 USD in machinery, and that the distinction between micro-enterprises and small enterprises is on about 2,000 USD investment in machinery. Of course, these calculations are based on a fluctuating exchange rate between the USD and the Tanzanian Shilling but nevertheless, they gave a good indication of the required worth of the investment in machinery for the different size groups in Tanzania.

micro enterprises, this approach of measuring employment at the firm level is misleading because it rapidly leads to a misinterpretation of the firm size. Take as an example a firm with four active owner-managers, one employee and one non-paid family member of one of the owner-managers. If only looked at the number of employees, the size of this firm is only one person but in fact it is a firm with six employed persons: the four active owner-managers, the one employee, and the one non-salaried family member. Therefore, measuring the number of employed persons gives better and more accurate results for the determination of the firm size than measuring only the number of employees with small businesses.

The second issue with the measurement of employment is the number of working hours. The labor contract with employees can easily be taken as a point of departure for the employees, and then a working time factor, preferably with one decimal, can be distinguished. For example, if the official full working week is determined at 36 hours and an employee has a contract for 18 hours, then the working time factor of this person is to be expressed as 0.5. On a more aggregated level, a distinction can be made between full-time employees and part-time employees (the latter works significant less than 36 hours in this example), and even between small part-time employees (e.g., less than half of the hours of a full working week, following our example less than 18 hours) and large part-time employees (follow previous example: half or more than half of the number of hours of a full working week, so 18 or more than 18 hours but less than 36 hours). Next to the distinction between full-time employees and part-time employees based on the contractual working hours, a distinction can be made on the number of worked months in a year. Here, the solution is evident: divide the number of full-time worked months by 12, and then the working time factor will occur. Also, part-time employment on the basis of the official worked hours can be incorporated in this approach of working a limited number of months in a year.

Even with these two issues, we are not fully done with the measurement of employment in small businesses, from the perspective of employees. First, the number of official working hours of an employee may deviate from the actual number of worked hours, for example, as a result of working overtime or not making enough hours. Second, working hours may deviate in terms of effectiveness, both between persons and between periods in time with one person. All these if and buts can be avoided by just measuring the number of employed people, irrespective of the number working hours for each person. This just counting heads is simple but may lead to negligent results as far as the measurement of firm size is concerned.

So, with the expression of the size of the small firm in terms of the number of employees, serious mistakes can be made, in order to typify the real size of the firm. This is even further complicated by the incorporation of the number of working hours of the entrepreneur himself. As the entrepreneur by definition does not have an employment contract in which the number of working hours is formally specified, especially with no limits in an upward sense but neither in a downward sense, it is impossible to specify a formal working time factor for the entrepreneur. However, it makes a great difference whether the entrepreneur works 36 hours per week or 72 hours per week: in the latter case, his working time factor can in fact be interpreted as 2.0 indeed.

Employment is only one way to look at firm size. Other frequently used firm size indicators are sales, assets, and profits (see, e.g., Shepherd & Wiklund, 2013). Note that employment and assets are by nature very different from sales and profits. Employment and assets can be seen as the traditional forms of input for production, also classically known as labor and capital. Sales and profit (the latter can also be interpreted as the difference between sales, on the one hand, and costs of input, on the other) can be seen as forms of output of the firm (although the latter is more or less balanced, as being sales minus costs of input). The level of sales (also called turnover) can be derived directly from the profit and loss statement of the firm, whereas the value of the assets can be derived directly from the balance sheet of the firm. Further, employment and assets should be measured at a certain moment in time, whereas sales and profits flow during a certain period.

When discussing the size of small firms, the term resource poverty can be brought in, indicating the vulnerability of a small firm due to its limited size (see also the next section). However, collaboration among small firms has been the answer to this weakness of small firms since ages. In earlier days, and still today, we can point at cooperatives and buying groups, in which small firms collaborate. In later days, and still today, we can point at trade associations, franchise organizations, and incubators, in which small firms collaborate. Creating scale economies through collaboration by small businesses is one good way to fight the liabilities of smallness, in the competition with large firms.

### *1.4.2. Qualitative Characteristics*

*In this section, eight qualitative characteristics are distinguished: the prominent role of the entrepreneur, the focus on the short-term, the strong regional/local focus, the complicated performance measurement, the high prevalence of family businesses, the simple formal organograms, the low degree of formalization, and finally the great importance of umbrella organizations.*

Next to aforementioned quantitative characteristics, small businesses also have distinct qualitative characteristics, when compared with large firms. Welsh and White (1981) phrased this very well: *a small business is not a little big business*. In other words, it is not only firm size that matters, small businesses also show distinct features when compared with large firms. According to Welsh and White (1981), the one special condition that the very size of small businesses create is resource poverty. They mention a number of explanations for this resource poverty:

(1) Small businesses tend to be clustered in highly fragmented industries that have many competitors which are prone to price-cutting as a way to build revenues; however, this approach of price-cutting also quickly destroys profits.
(2) The owner-manager's salary in a small business represents a much larger fraction of revenues than in a large firm, and often such a large fraction that

little is left over to pay additional managers, to reward investors, to pay for the kind of accounting and bookkeeping services they need, and to test and to train new employees.

(3) External forces tend to have relatively much impact, as small businesses only have limited influence on their business environments when compared with large firms, for instance, changes in government regulations, tax laws, and interest rates.

Welsh and White (1981) also mentioned a number of useful management tools for small businesses. According to these authors, liquidity must be a prime objective for the owner-managers of small businesses. Therefore, they have to make a solid prediction of future cash flows (with both cash and bank accounts). According to these authors, a small business can survive a surprisingly long time without a profit, the firm "only" fails on the day it cannot meet one or more critical payments. In other words, "cash = king."

Although at least two basic ideas in the paper by Welsh and White are still valid (viz., a small business is in its format and appearance different from a large firm, and the major importance of liquidity for the firm), their paper is also somewhat dated, which is not so strange for a paper that was published more than 35 years ago. The main dated issues come from the fact that nowadays, we see a prominent role for high-tech start-ups (by definition also small businesses, but not (necessarily) in "wholesaling, retailing, services, job-shop manufacturing," as Welsh and White (1981) indicated the main sectors for small businesses in those days) and a ditto prominent role for the so-called open innovation (which in fact also gives small businesses access to reap a substantial part of scale economies without requiring heavy investments in order to grow the businesses).

There are eight main and interacting qualitative characteristics of small businesses: the prominent role of the entrepreneur, the focus on the short-term, the strong regional/local focus, the complicated performance measurement, the high prevalence of family businesses, the simple formal organograms, the low degree of formalization, and finally the great importance of umbrella organizations. They will be all eight dealt with below.

The most important qualitative characteristic of small businesses is the crucial annex prominent role of the entrepreneur, also known as the owner-manager of the firm: he is both the daily manager and the (major) owner of the firm. The entrepreneur may also be the founder of the firm, although this is not necessarily the case, when he has acquired the firm from another entrepreneur. This qualitative characteristic is also one of the most distinguishing qualitative characteristics of a small business, as large firms in general have a board, a management team, multiple owners/shareholders, and a shareholder meeting. So, the entrepreneur of the small business is in daily charge (through management) and also in final charge (through ownership) of the firm. One quote of the author of this book sounds: "if you want to understand the small business, you should first understand the entrepreneur, otherwise you will never understand the firm."

Notice that there may be more than one owner-manager of one small business, which might be even more the case when a small business grows larger.

The next important qualitative characteristic of small businesses is their focus on the short-term. Although small businesses may live for a long time, they normally only have a business planning on the operational level, at best, and often this planning has (greatly) an informal, non-written character (as opposed to a formal and written business plan often practiced by large companies). Strategic planning, for example, for a five-year period, and yearly working plans are in general non-issues among small businesses, also due to the informal character of working within small businesses (see the seventh qualitative characteristic in this section). One of the reasons of this focus on the short-term is that the owner-manager of a small business is often not accountable for his long-term plans toward stakeholders. Note also that any business plan may be under revision and changed after some time.

Also, an important qualitative characteristic of small businesses is their strong regional and/or local focus: small businesses in fact make part of the regional and/or local landscape or in other words, they make part of the connecting regional and/or local community. Many stakeholders of the firm (especially, but not necessarily only, employees, clients, and suppliers) come from the area in which the firm is physically established. It also often happens that the entrepreneur (and his family) lives (live) in the same area as the one in which the firm operates, which may have an impact on both the firm and the entrepreneur, as in the firm the entrepreneur may be confronted with issues from his private life and in his private life he may be confronted with issues from his firm.

Further, small businesses in general have to do with a complicated performance measurement: the net profit level (one of the most usual economic performance measures) is often not an adequate economic performance measurement for small businesses. The reason for this is that the entrepreneur may be able to influence the cost level of his firm profit because, to a certain extent, he determines personally the level of his own entrepreneurial income. As this own entrepreneurial income is a major cost item for the firm, it is clear that the level of firm profit does not necessarily reflect the real economic health of the firm. The connection between the firm profit, on the one hand, and the entrepreneurial income, on the other, works in two directions. First, the entrepreneur may appropriate a higher than standard entrepreneurial income for himself (e.g., for financing expenses in the private sphere, possibly in a period that the firm performs rather well, and thus he pushes the firm profit in an artificial way to a lower level than it in fact is). Second, the entrepreneur may appropriate a lower than normal entrepreneurial income for himself (e.g., because the sales of the firm do not come up to the expectations, and thus he pulls the firm level in an artificial way to a higher level than it in fact is). The frequently used ratio earnings before interest and taxes (EBIT) has the same disadvantages as the standard net profit level. An alternative economic performance measure may be the level of gross profit, that is, the difference between sales and costs before the deduction of the entrepreneurial income. However, this economic performance measure is not always clear, as not all costs for the firm are incorporated (cf. the difference between gross and net). Therefore, one of the best economic performance measures for small businesses is the level of labor productivity of the firm, being the level of firm sales divided by the number of employed people at the firm (so, the average sales per active person). This economic performance measure, in fact, indicates the virtual ceiling to which the costs per employed person may rise while still being a profitable business. However, small businesses often use different performance measures at the same time (both financial, targeting at the achievement of the economic goals of the firm, and non-financial, targeting at the firm's broader operational effectiveness), and firm growth is in general one of the most frequently used performance measure with small businesses.

The fifth qualitative characteristic of small businesses is that many of them are family businesses, although there is no real consensus on the best definition of a family business (using a certain definition may also influence the extent to which small businesses are family businesses). The main characteristic of a family business is that one family plays a crucial role within the firm, for example, in the management or in the equity of the firm (although, in principle, it may also be two or more families instead of just one family). There are two main approaches in identifying family businesses. First, in the current situation, two or more members of one family play a crucial role in the management and/or in the ownership of the firm (the governance aspect). Second, the previous owner-manager of the firm is a family member of the current owner-manager, for example, father and son (the generation aspect). For a proper understanding of a family business, it is important to realize that there is an overlap between the interests and activities of the family, on the one hand, and the interests and activities of the business, on the other. It also happens that single-owned firms are considered to be family business; although this may be true in a strict sense (the single owner-manager indeed represents one family), it does not make much sense, as the role of other family members is left out of consideration in this situation.

A simple formal organogram or organizational structure is the sixth qualitative characteristic of small businesses, as most small businesses do not have a very complicated formal way of organizing their internal processes. The formal organograms of, for example, large multinationals or public organizations often look complicated (and frequently they look understandable), with many hierarchical layers and responsibility lines (this especially counts for the so-called matrix in which people have more than one reporting line). But in small businesses, there are only few departments, if they are even there, with only few layers and only few responsibility lines, and in the end any employee reports to the owner-manager of the firm, directly or indirectly. The main explanation for these simple formal organizational structures of small businesses is primarily the limited size of small businesses and the solo ownership of the firm. However, being a family business may be the basis of a complicated (be it formal or informal) organizational structure of a small businesses, that even may not be captured in a single picture with a limited number of dimensions.

Also, small businesses are known for their low degree of formalization, that is, they show informal working relationships within the firm. Although it is in general clear who is the real boss within the firm (that is the entrepreneur, as he is the owner-manager), there is in general a low hierarchical distance between the entrepreneur, on the one hand, and the employees, on the other. This seventh qualitative characteristic of small businesses primarily has to do with the limited size of the small businesses (in a small community people meet often), but it may also have to do with the fact that the owner-manager is often directly involved in the primary processes of the firm and that he is often also active on the shop floor. Further, the low degree of formalization of small businesses may also have to do with the fact that employees can be members of the same family as the entrepreneur, as it is the case with family businesses.

Finally, the so-called umbrella organizations are important for small businesses. The main weak point of small businesses compared to large firms is the lack of scale on which they operate and the absence of scale advantages in general. Collaboration with other small businesses (e.g., within a cooperation, a trade association, a franchise organization, or a shopkeepers' association) may lead to considerable joint scale economies of the participating small businesses, which can be mutually shared among the participating small businesses. The combination of the scale advantages through collaboration and the high motivation of (still independent) small business owners makes small businesses very well able to compete with large firms and even gives them a specific competitive advantage.

## Readings Section 1.4


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## 1.5. Stages in the Development of Small Businesses (Life Cycle of the Firm)

*In this section, the basic concept of the life cycle of the firm and the differences during the life cycle of the firm are dealt with. Additionally, specific attention is paid to protection of the start-up firm (in terms of registered formal protection, non-registered formal protection, and informal protection) and to exit strategies (in terms of squeeze the firm, liquidate the firm, sell the firm, have the firm go bankrupt, re-orientate the firm, and IPO).*

A firm is not a static and once-and-for-all phenomenon but it is a lively and dynamic phenomenon that develops to a lesser or to a larger extent in the course of time and thus shows different appearances and sizes in the course of time. The development of the firm over time in general consists of a number of connected different stages. These stages may be expressed in terms of the size of the firm size (quantitative aspects) but the stages also may be expressed in terms of the appearance of the firm (qualitative aspects). Together, these stages form the life cycle of the firm. First, we take a look at the general development of the firm in terms of size. In Section 1.5.1, the specific subject of protection of the start-up firm will be dealt with. In Section 1.5.2, the specific subject of exit strategies will be dealt with.

The general concept of the life cycle of the firm is helpful here, see Figure 1. This concept is partly based on the product life cycle concept that is often used in marketing, in order to analyze the rise and fall of products. And even marketing seems to have borrowed the concept of the life cycle from biology, in which the life cycle is a sequence of life stages that an organism undergoes from birth to decline. Here, the product life cycle is in fact applied to the development of a



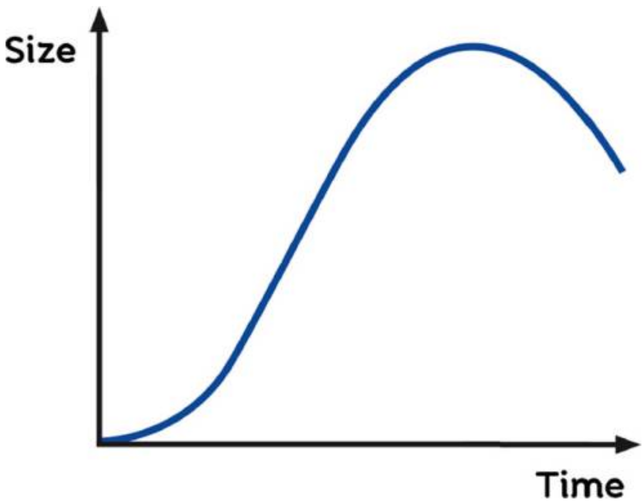


Figure 1: The Life Cycle of the Firm.

small business, viz. the life cycle of the firm (so to say: the firm takes the place of the product). On the horizontal axis of the figure, the dimension "time" is presented. Time is the irreversible succession of the past through the present to the future. One of the most obvious criteria in the context of the development of a small firm is years, but other criteria are also possible, for example, weeks, months, or blocks of more than one year. On the vertical axis, the dimension firm size is presented. As we already know from Section 1.4.1, one of the most common features to express the size of the small business is its employment or number of employed people. However, in the remainder of that section, it was also shown that there are alternative quantitative measures as well, like sales, assets, and profits.

Elaborating on the previous paragraph, the stages in the development of a firm can be seen as combinations of intervals of time, on the one hand, and firm size, on the other. In principle, the life cycle of the firm exists of four stages: (1) the start-up stage, (2) the growth stage, (3) the maturity stage, and (4) the decline stage. The start-up stage reflects the initial steps of the firm right after its founding; in this stage, the firm represents a combination of small size and young age. In the second stage, the growth stage (nowadays also called the scale-up stage), the firm takes off after its initial steps; in this stage, the firm employs more people than in the initial stage, after a number of years of its existence, so further in time as well. In the maturity stage, the third stage, the firm finds itself after a number of years in a more or less stable situation in terms of the number of employed people. Finally, in the decline stage, or in the last years of its existence, the firm has grown older and cuts back in terms of employed people and prepares for the end in its existence.

Although the life cycle of the firm model is an illustrative and useful model, it still is only a conceptual model: the model is basically meant to understand what may happen with a firm in the course of time. The life cycle of the firm model is not a normative model, as it does not state what the firm should do, in order to come to its further development. Neither is the life cycle of the firm model a predictive model, as it will not predict what the firm inevitably is going to do, in terms of its further development. Five illustrations of its conceptual character can be found in this paragraph. Instead of entering the growth stage, which follows the start-up stage during the life cycle of the firm model, the entrepreneur may choose to stabilize the firm in terms of number of employed people, and not to grow any further, for example, because the entrepreneur does not want to have any interference in the control of the firm from others. In fact, here the start-up firm progresses into a mature firm preliminary, without any intermediate stage of growth. However, it is also possible that the start-up firm advances into a decline stage right after its start-up stage, for example, because its product does not appeal to the market, and then the firm develops toward the end of its existence right after its start-up stage. Given the fact that the majority of start-ups die prematurely and do not survive the period of five years, it gives food to this example of the life cycle of the firm model. Next, it is also possible that, after the growth stage, the firm may re-invent itself, and, for example, comes up with innovative products, and enters in fact a new start-up stage. In this example, the firm does not (yet) progress into a mature firm after its (first) growth stage. Another example is that the firm may, after the growth stage, move into the decline stage prematurely, for example (again) because its product does not appeal to the market, facing the end of its existence, without having been in a maturity stage at all. Finally, it is also possible that, after the maturity stage, the firm may re-invent itself and come into a new growth stage, for example, again comes up with innovative products, instead of entering the expected decline stage. So, there is number of practical applications of the conceptual model of the life cycle of the firm and the life cycle of the firm is not a strict pathway to follow. Note that more examples can be thought of instead of only these five examples The essence of the life cycle of the firm is that firms that are in different stages during the life cycle of the firm show different characteristics, or that one firm shows different characteristics in different stages during the life cycle of its existence. There is a lot of differences that can be dealt with, but here only three examples are given, concerning important characteristics of the firm. The first example of differences during the life cycle of the firm concerns the diversification in terms of firm sales. In the start-up stage, the firm only has a limited set of activities, almost by definition, and thus the sales can be seen as (more or less) a mono-culture. In the next two stages (viz. growth and maturity), the diversification of sales will increase, compared to the start-up stage, as a result of increasing the number of activities. Finally, in the decline stage, the diversification of sales will decrease, as compared to the maturity stage, because the number of activities that is carried out by the firm is reduced.

The second example of differences during the life cycle of the firm concerns the diversification in employment of the firm. In the first stage, there will be most often only the entrepreneur (or sometimes a few entrepreneurs who started the firm together) and at best some support staff or active family members to help him, again almost by definition. However, as the firm develops new activities and jumps into the growth stage and eventually the maturity stage, the diversification of the employment of the firm will increase, compared to the start-up stage, because the firm has to hire new personnel and has to apply task division among its employees. Finally, in the decline stage, the diversification of employment will decrease, because the number of activities that is carried out by the firm is reduced.

The third example of differences during the life cycle of the firm is the financing of the firm. In the start-up stage, business finance will mainly come from the entrepreneur himself and maybe from certain relatives, friends, and acquaintances, again almost by definition. Commercial banks will not be very much interested in the firm in this stage of its development, because not much collateral is available, and most likely the entrepreneur does not have a long track record of previous successful experiences. In other words, the start-up stage is in general too risky for commercial banks. In the next two stages, formal financers may come in, like commercial banks and perhaps venture capitalists: apparently they are willing to do so because the entrepreneur and the firm have proven themselves and because the risk decreases for the financers. In the decline stage, investors will withdraw from the scene, because not much future is left, in which the loaned money will be paid back. Jones, MacPherson, and Jayawarna (2014) discussed the relationship between the life cycle of the firm, on the one hand, and the assumed level of investment risk by investors, on the other. Their assumption was that the further the firm gets in its life cycle, the lower will be the assumed level of investment risk by investors. This assumption makes sense, because the firm has proven its rationale of existence in the course of time. The authors also suggested a connected decreasing level of informality with the investors of the firm, during the life cycle of the firm: personal finance, family and friends, bootstrapping, internal funding, seed capital, public/grant funding, business angels, formal venture capitalists, non-financial corporations, commercial banks, and finally initial public offering (IPO).

Given these differences between the stages during the life cycle of the firm, it can also be logically derived that a firm may develop itself through its life cycle as a result of operational changes. Is growth of the firm possible without diversification of sales and employment? Is growth of the firm possible with the initial financers of the firm only? In practice however, it seems to be an iterative process: on the one hand, sales diversification, employment diversification and diversification of financers enable the firm to grow further; on the other hand, the growth of the firm may also lead to more diversification of sales and employment and financers as well. McKelvie and Wiklund (2010) called this distinction the difference between growth as an output (in which firm growth is in fact the dependent variable, where the focus is on the factors that determine firm growth) and the output of growth (in which firm growth is in fact the independent variable, where the focus is on the changes that result from firm growth).

The current ideas about the life cycle of the firm, especially concerning the different stages during the life cycle of the firm, go back as far as Greiner (1972). His famous article on the life cycle of the firm, revealing called "Evolution and Revolution as Organizations Grow," published in the *Harvard Business Review*, can be considered as the main starting point of the modern thinking about the life cycle of the firm. The author of this book owes a lot to this paper, although no real empirical proof with this chapter was provided. Also, the "evolution stages" that Greiner distinguished may be disputable to a certain extent: there is no clear proof that growth through creativity, growth through direction, growth through delegation, growth through coordination, and growth through collaboration (as Greiner called them) logically follow each other in time. Further, it is disputable that the development of firms just ends with growth through collaboration, this seems to be an open end of the life cycle of the firm. It is also questionable whether the crises of leadership, autonomy, control, and red tape are the real "revolutionary stages" in the development of the firm, as this paper suggests. However, it is still an intriguing thought in this respect that a "revolutionary stage" (or conflict) is placed between any two "evolutionary stages" (or stages during the life cycle of the firm). In other words, there is no progress with the firm without any crisis with the firm, according to Greiner (1972).

One of the most important approaches of the life cycle of small business, the very subject of this book, is more or less an application of Greiner's seminal model. This model was made by Churchill and Lewis (1983); their paper was also published in *Harvard Business Review*. Nevertheless, again no real empirical proof was provided with the paper. According to these authors, firm size, dispersion of activities, and complexity of the operations increase from small to large (on the vertical axis), as the firm develops in terms of age of the organization or in terms of development from young to mature (on the horizontal axis). The firm develops through a connected series of five stages of growth:

(1) Existence: in this stage, the main problems of the firm are to acquire customers and to deliver the product or service contracted for.
(2) Survival: in this stage, the key problems of the firm have shifted to the relationship between revenues and expenses, or in other words, to profitability.
(3) Success: in this stage, the main decision the owner-manager has to make is whether to exploit the firm's accomplishments and to expand the firm further ("disengage"), or to keep the firm stable and profitable.
(4) Take-off: in this stage, the key problem is how to grow further with the firm and how to finance the firm growth. Note that the decision to expand the firm further has yet been taken.
(5) Resource maturity: in this stage, the greatest concern of the firm is to consolidate and to control the financial gains brought on by the rapid growth and to retain the advantages of small size (including flexibility of response and entrepreneurial spirit).

So, in each stage of the development of the small business, different problems and corresponding turnings occur. Churchill and Lewis (1983) did not make it fully clear whether these turnings are made deliberately and whether these turnings represent free choices made by the entrepreneur or that the turnings are taken because the entrepreneur has been left no choice to act differently, for the survival of his firm. In practice, most often, it will be a combination of free choice of the entrepreneur, on the one hand, and external force to make a choice, on the other.

Churchill and Lewis (1983) identified a number of scenarios how the small business may develop in time. In the top scenario, the firm develops prosperously, in terms of size, including increased dispersion, but also accompanied by an increasing complexity of the firm. In the lowest scenario, all turnings (in every stage) are toward fold, in terms of to stop trading or to stop functioning. In between the top scenario and the lowest scenario, a number of different scenarios can be distinguished. In each stage, the scenario to sell the firm is presented. Next to that, also a horizontal track can be followed, in which the firm does not grow further, but remains more or less on the same size level.

A similar and related model was presented by Scott and Bruce (1987), published in Long Range Planning. Their approach in terms of stages is quite similar to the approach by Churchill and Lewis (1983). Scott and Bruce (1987) called their five stages: inception stage, survival stage, growth stage, expansion stage, and maturity stage, respectively. They more or less followed the horizontal axis from Churchill and Lewis (1983), with age of business, from young to mature, but they used a less sophisticated vertical axis (with only size). Unfortunately, again no real empirical evidence was provided with the paper. Following Greiner (1972), they distinguished one of the most likely crises between each two stages of small business development, which had to be overcome before entering the next stage of development:

(1) The most likely crises between the inception stage and the survival stage, according to these authors, are the emphasis on profit, administrative demands, and increased activity and its demands on time.
(2) The most likely crises between the survival stage and the growth stage, according to these authors, are overtrading, the increased complexity of expanded distribution channels, changes in the basis of competition and pressures for information.
(3) The most likely crises between the growth stage and the expansion stage, according to these authors, are entry of larger competitors and the demands of expansion into new markets or products.
(4) The most likely crises between the expansion stage and the maturity stage, according to these authors, are the distance of top management from the so-called action on the floor and the need for external focus.

In general, the dimension on the horizontal axis is rather easy measurable: it is time, and therefore, years are the most obvious measure. If a short interval is studied, it may be recommended to use months, as a submeasure of the time dimension. The vertical axis may raise more problems in terms of measurement though. In principle, the main dimension on the vertical axis is firm size, as we are dealing with growth of the firm, and growth is here nothing more than the differences in size at different moments in time. But how should growth best be measured? Shepherd and Wiklund (2013) analyzed 82 prior studies of firm growth, and they concluded that the level of sales was the most frequently used indicator of growth (mentioned 61 times in their study), on a far distance followed by the number of employees (mentioned 13 times), the level of profit (nine times), the value of equity/assets[3] (mentioned six times), and a residual category others (mentioned 15 times). As examples of the last category, the authors mentioned the number of franchise outlets and the number of regions covered. An important comment should be made here with the use of the indicator employees in the context of this book again. For the characterization of small business, it is better to work with the indicator number of employed people, so not only employees but also active owners (and even their non-salaried active family members and even their freelancers). Not including the active owners (and the

[3]Using the term equity/assets is strange, because they are clearly different. Equity means ownership of the firm and assets means the worth of the firm (equity plus debt). The interpretation of the author of this book is that Shepherd and Wiklund (2013) meant to point at the value of the assets of the firm, as the use of that concept makes much more sense than the use of the concept of equity here.

possible non-salaried active family members and freelancers) may be very misleading to typify firm size, because it may have a strong impact on the small number of employed people in a small firm.

When firm growth is concerned, special attention should be paid to rapid growing firms. Next to being an intriguing phenomena, these rapid firms are important because they give a strong impulse to the economy, as they swiftly produce much employment, both jobs directly (employees of the firm) and jobs indirectly (mainly employees of supplying firms). However, there is not a single best definition of what is rapid growth of a firm, neither concerning the level of increase of size of the firm, nor the time interval concerned. These rapid growing firms are often called gazelle firms, after the animal gazelle, a kind of antelope, known (among others) for its ability to run at high speed. Another term for a fast-growing firm, as an alternative for the term gazelle firm, is the exponential organization, coined by Ismail, Malone, and Van Geest (2014) as: "[…] one whose impact (or output) is disproportionally large – at least 10× larger – compared to its peers because of the use of new organizational techniques that leverage accelerating technologies" (p. 18). Although the use of the word impact may be disputed here, and although the choice for at least 10 times larger may be arbitrary, and although the explanation sought for in new organization techniques that leverage accelerating technologies, the direction of this definition is clear: it is about growth beyond proportion, within a not too long period.

Finally, attention is paid to the decision how to close the firm, instead of thinking in terms of continuity of the firm. In the model by Churchill and Lewis (1983), it is called the fold situation, and this term is also used by Scott and Bruce (1987). In principle, three tracks may be followed by the entrepreneur: he may choose to close the firm prematurely and voluntary, he may choose to sell the firm to another person or to another organization, or he may choose to let the firm go bankrupt and accept the consequences. Let us take the situation in bad weather as a setting here, with the firm writing red figures for a longer period, because that is one relevant period to think about the future of the firm. The entrepreneur may decide to close his firm prematurely and voluntary (although the bad economic situation may not give him a feeling of voluntary), thus preventing from in fact bringing more money of his own to the firm and hence spoiling his old day pension (and that of his spouse as well). However, the entrepreneur may also look for a third party to buy his firm (or parts of his firm), thus giving an extra impulse to his old day pension. Or the entrepreneur may go on as long as his firms go bankrupt, thus leaving him with the rest of the debts of the bankruptcy and the corresponding claim on his old day pension.

Failure of entrepreneurs is a sensitive subject in this context: to what extent can the entrepreneur be held responsible for the decease of his firm (and the loss of the jobs of his employees), and to what extent are external reasons responsible for the decease of his firm? A kind of good failure may be the one from which the entrepreneur learns a lot and that makes him even a better entrepreneur in the future (this is one example of the so-called serial entrepreneur).

### 1.5.1. Protection of the Start-up Firm

*In this section, attention is paid to the different forms of protection of the start-up firm: registered formal protection, non-registered formal protection, and informal protection. Different subforms are also distinguished. The investments that the entrepreneur makes for his start-up and for his innovation may take four different forms: money, time, reputation, and goodwill.*

Almost by definition, a start-up is centered around an innovation, be it more or less incremental, and even sometimes far into the direction of radical. Apparently, the entrepreneur, who is involved with this innovation and who is also responsible for the start-up, expects that there is room in the market to sell this innovation in the future, and therefore he is willing to make investments. However, the future by definition is uncertain, and therefore there is no guarantee that the start-up firm will be successful in the future. In other words, there is no guarantee that the entrepreneur will earn back the investments that he has made for the innovation and for bringing the innovation to the market. If the innovation will not be adopted by the market, so if the firm will not be successful with its innovation, then the entrepreneur by definition will lose his investments, all or partly, at least the investments which he did not secure and/or did not earn back yet. So the entrepreneur of the start-up runs a risk that he will lose his investments. Loosing these investments may even happen before the start of the firm, when the nascent entrepreneur does not arrive in the start-up stage but remains in the nascent stage and stops before the start-up threshold. However, an entrepreneur in general is an optimist, as he expects that the future will develop in a direction that will be beneficial for him, for his firm and for his innovation. Otherwise, normally, he would not accept to run the risk of losing the investments that he has made for his innovation.

The investments that the entrepreneur makes for his start-up and for his innovation may take four different forms: money, time, reputation, and goodwill. Obviously, this also counts for new ventures or projects that are undertaken by existing firms but the focus in this subsection is on the start-up firm. Money and time can be considered as tangible sources, whereas reputation and goodwill can be considered as intangible sources. All four sources, though different, may be connected to each other.

In the start-up stage, the perceived level of uncertainty with investors and financers may be high, because the product or service, on which the start-up is based, has not really proven itself yet. The entrepreneur himself may also be an uncertain factor, as he may not have any track record of previous entrepreneurial successes (and/or other (business) successes as well). Further, in general, the entrepreneur of a start-up may not have too much collateral, to reassure his (potential) investors and/or financers, in case of failure. Therefore, in this stage of the development of his firm, the entrepreneur will depend strongly on his own personal funding and on financing from his personal network, viz. family and friends. This is typically also the investments that the entrepreneur may lose in this stage, when his firm appears not to be successful.

Next to the money that the entrepreneur invests in his own start-up, he also invests his own time in starting the firm, without any direct and/or guaranteed financial compensation, or at least without any direct proper financial compensation. When his firms ceases to exist prematurely, or when the firm does not survive later, he will lose the worth of the invested hours. This may even be extended with the hours that, for example, family members or friends have put in the start-up firm, without any (proper) compensation. Based on the old proverb "time is money," with the help of an hourly fee, the invested time can also be added to above-mentioned money, as the two tangible forms of investments that the entrepreneur makes for his start-up and for his innovation.

The third source that the entrepreneur puts in his new firm is his good reputation, being the positive expectations that people (especially his stakeholders) have of this entrepreneur. If the entrepreneur makes a mess of his firm and/or of the development of his innovation, then he will to a lesser of higher degree lose his good reputation, especially as a result of the high popularity of social media in these days. Losing a good reputation by the entrepreneur means that the people, who had positive expectations of him, will be less willing to do business with him in the future, or they only will do business with him at higher costs to compensate an extra perceived risk. Bankruptcy does not necessarily implicate that an entrepreneur loses his good reputation, but bankruptcy hardly ever positively contributes to the good reputation of the entrepreneur.

The fourth source that the entrepreneur puts in his new firm is the non-paid goodwill of other people toward him when he start his firm. This non-paid goodwill may take the form of advice from the persons who deliver their goodwill and giving access to their networks, without any (proper) compensation. When the entrepreneur fails to live up to the expectations by the persons who gave their goodwill to him, leading to disappointment of these persons, then these persons may decide not to support the start-up anymore and they may even decide to spread that news to other persons as well. This situation may subsequently lead to the situation in which the entrepreneur has to spend more time to certain activities all by himself, without people giving him goodwill.

These four forms of investment all represent value, and the entrepreneur loses value when his start-up and his innovation are not successful in the future. There is always a certain level of risk involved for the entrepreneur, that failure will occur, as the future is uncertain, by definition. In order to prevent loosing value, the entrepreneur has to protect himself, his start-up firm and his innovation. From the extreme top to the bottom, four levels of protection can be identified (see also Kitching & Blackburn, 1998): registered formal protection, non-registered formal protection, informal protection and no protection. Obviously, the relevance of protection of innovation also counts for new ventures or projects that are undertaken by existing firms.

The most extreme form of innovation protection is registered formal protection. The first adjective (registered) means that this form of protection is incorporated in a public register, so there is a record that is accessible for people and for organizations. The second adjective (formal) means that this form of protection is officially recognized by the authorities in a certain context, for example, in a country or in a number of countries. Examples of registered formal protection are patents (that claim a monopoly on an invention for a certain period, because of its newness, innovativeness and applicability), registered designs (that claim a monopoly for a certain period on the visual aspects of an innovation), trademarks (that protect the use of a name or a logo for a certain period), and registered copyrights (that automatically come up with an idea). See Mol (2017, pp. 9−11) for a more extensive description of the four forms of registered formal protection.

The next level in the pyramid of innovation protection is non-registered formal protection. Again, this form of innovation protection is formal, meaning that it is officially recognized by the authorities in a certain context, for example, a country or a number of countries, but, in contrast to the former form of protection, there is not a public register that is accessible for people and for organizations. Two main forms of this form of innovation protection are confidentiality clauses in contracts (that state that the information concerned should not go outside of this relationship, for example, an employment relationship between an employer and an employee or a commercial relationship between a supplier and a client) and licensing (that give the user on a contractual basis the right to do something with the formally registered and protected innovation, see previous paragraph). One specific example of a confidentiality clause is the non-disclosure agreement (NDA) that is signed by the counterpart when an entrepreneur introduces his innovation to him, for example, a venture capitalist.

The third form of innovation protection is the informal one, the one that is not officially recognized and not publicly registered. A number of approaches can be distinguished here, like:

(1) branding (creating an image in the eyes and in the minds of the stakeholders);
(2) developing high-trust relationships with stakeholders (e.g., with clients, with employees or with partner organizations);
(3) creating lead time advantages (bringing the innovation to the market as soon as possible and not necessarily wait until the ideal product or service has been developed);
(4) developing the next version of the innovation as soon as possible (so that by the time competitors start to copy this innovation, the 2.0 version of this innovation is already available with the entrepreneur who developed the first edition of the innovation);
(5) building in technological protections to prevent others from copying the innovation (mainly applicable with software); and
(6) keeping things quiet (i.e., not telling anyone about the innovation).

Next to these three forms of innovation protection, the entrepreneur may also decide not to undertake any protective action at all for his innovation. The reasons for this choice can be that the entrepreneur is unknown with certain forms of innovation protection, or it can be based on the estimation that any protection action is useless, and/or it can be based on the estimation that the costs of protecting the innovation are too high, in terms of money or time. This absence of any form of innovation protection can be a good benchmark toward the other forms of innovation protection, and it can also form the basis of the decision process of the entrepreneur as far as protection of his innovation is concerned.

### *1.5.2. Exit Strategies*

*In this section, attention is paid to six exit strategies: squeeze the firm, liquidate the firm, sell the firm, have the firm go bankrupt, re-orientate the firm, and IPO.*

It was already presented in Section 1.5 of this book that the life cycle of the firm is not a predictive model, in which the firm automatically develops and declines in a predefined way after a number of stages. In principle, the decline stage may start anywhere during the life cycle, even right after the start of the firm, and even before the start of the firm (so before the start-up threshold, when the initial business idea proves not to be viable). Therefore, the entrepreneur should continuously think about an exit strategy (or for small businesses better to be called an entrepreneurial exit approach), briefly described as a deliberate preparation to stop with the firm in its current form, because to carry on with the firm is not a viable alternative for the entrepreneur (anymore), in a way that serves him best. As the life cycle of the firm contains dynamic aspects, and as the firm is under continuous influence of an ever-changing environment, the entrepreneur should also continuously think about further developing his exit strategy, in order to prepare him for the end of firm. It is noted that in practice the word exit is also for just selling the firm to one or more buyers but in this section and in this book the concept of exit is broader, in fact any ending of the firm in its current form. Given his exit strategy, the entrepreneur should also timely think about the road to exit or his exit route.

Below, six relevant exit strategies for small businesses are presented:

(1) Squeeze the firm: get as much money as possible out of the firm in a certain period, for example, in the form of a salary, a bonus and/or a special class of shares that gives the right to certain dividends in the future. A good planning is needed here, because the money should not be taken out of the firm first when it is needed in the firm in a later stage again.
(2) Liquidate the firm: simply called quit with the firm and close the business doors. However, in principle any proceeds from the assets must first be used to repay the creditors of the firm, whereas only the remainder of the value of the assets goes to the owner of the firm or will be divided among the owners of the firm.
(3) Sell the firm: passing the ownership of the firm to another party that may come from the inside (e.g., employees or family members) or from the outside (e.g., clients, suppliers, competitors, or investors). Another often used distinction in this context is the one between the management buy-out (MBO), in which the firm is sold to the existing management team of the firm, versus the management buy-in (MBI), in which the firm is sold to an

external management team. One advantage of selling the firm may be the preservation of employment of the firm (that is, securing the jobs of the employees). Selling the firm may be done integrally or in parts.

(4) Have the firm go bankrupt: this may prevent the firm from more loss-making and more assaults on the equity of the entrepreneur in the future. The initiative of this exit strategy should come from the outside, mostly from the suppliers' side, because their bills are not paid anymore by the client firm.
(5) Re-orientate the firm: change the course of the firm and act in another way than before. One specific move may be to leave the current general market and to choose for a specific niche in the market, for example, directed at a specific target group or with a specific product or service.
(6) IPO (initial public offering): although this is only reserved for a very small minority of start-ups, and not feasible for almost all small business, it should be mentioned as a possibility as such. In fact, part or all of the equity is sold from the owner(s) to a general public, leading to a strong cash position for the owner(s).



An entrepreneurial exit can be a voluntary action, even an action that was planned a long time ago. However, an entrepreneurial exit may also be a forced situation, and a sudden situation, that just happens to the entrepreneur, because this is the best or the least-worse alternative for him. In the latter situation, it may have to do with the personal situation of the entrepreneur, for example, sickness or divorce, in which he may not be capable to (fully) run his entrepreneurial operations in an optimal way. Anticipation on these forced situations and taking these forced situations openly in consideration may be useful, both in terms of probability and of impact. The firm exit may be speeded up by environmental influences, for example, the bankruptcy of an important client.

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## 1.6. Different Types of Entrepreneurs

*The typology of entrepreneurs is the central theme in this section, with seven main entrepreneurial types (nascent entrepreneurs, new entrepreneurs, serial entrepreneurs, portfolio entrepreneurs, former entrepreneurs, gazelle entrepreneurs, and stable entrepreneurs) and 11 additional entrepreneurial types (accidental entrepreneurs, hybrid entrepreneurs, lifestyle entrepreneurs, criminal entrepreneurs, sustainable entrepreneurs, social entrepreneurs, studentrepreneurs, corporate entrepreneurs, academic entrepreneurs, publicpreneurs, and governpreneurs).*

The entrepreneur in this book is the person who practices entrepreneurship and manages his own firm on a daily basis. However, entrepreneurs are not an homogenous species, on the contrary: entrepreneurs come in many different forms. In this section of the book, seven main types of entrepreneurs are introduced to the reader, the so-called basic typology of entrepreneurs. The challenge of coming to a list of seven main entrepreneurial types was more in the limitation of coming to a short list of these seven types only, and not in extending the list of entrepreneurial types further and further. The first criteria for composing this short list of seven main entrepreneurial types were the attention that is paid to these entrepreneurial types in the recent entrepreneurship literature and the actual fit that these entrepreneurial types have with current practice. Next to these first criteria, for this book, it is also important that the type of entrepreneur can be placed in the light of small businesses (and hence, not exclusively in, e.g., large businesses, public organizations, not-for-profit organizations, or non-governmental organizations). For this book, the distinction into the seven main types of entrepreneurs was made as follows: nascent entrepreneurs, new entrepreneurs, serial entrepreneurs, portfolio entrepreneurs, former entrepreneurs, gazelle entrepreneurs, and stable entrepreneurs. This is the short list that is used in this section.

Next to these seven main entrepreneurial types, a number of other entrepreneurial types can be distinguished as well, they will be dealt with in the end of this section. This is the additional typology of entrepreneurs, 11 in number: accidental entrepreneurs, hybrid entrepreneurs, lifestyle entrepreneurs, criminal entrepreneurs, sustainable entrepreneurs, social entrepreneurs, studentrepreneurs, corporate entrepreneurs, academic entrepreneurs, publicpreneurs, and governpreneurs.

As with many typologies, an overlap among the different types may occur. Beforehand, it is even admitted that these 18 types of entrepreneurs are not mutually exclusive and that the 18 types of entrepreneurs even often overlap. And the list is open-ended, meaning that extension of the list in the future is very well possible, even very likely.

The first type of entrepreneurs in the basic typology is the nascent entrepreneur. It is no coincidence that the basic typology starts with this type, because the nascent entrepreneur in fact is not an entrepreneur yet, or in other words, his birth as an entrepreneur did not yet take place. The nascent entrepreneurs is a person who seriously considers to start his own firm, but who has not started yet. A number of nascent entrepreneurs will indeed start their own firm after some time, but a number of nascent entrepreneurs will never start their own firm, and become, for example, employees in an organization. Nascent entrepreneurs are so-to-say in the minus one stage of the life cycle of the firm, although they will not start their own business overnight but in a process-like way.

A new entrepreneur (also known as a novice entrepreneur or a start-up entrepreneur) is somebody who has recently started his own firm, without any previous personal entrepreneurial history (if the latter occurs, than we deal with a serial entrepreneur or a portfolio entrepreneur, see below in this section). There is no non-ambiguous indication how long a start-up period takes, but it is plausible to mention that it is a limited number of years, for example, maximum three years, although next to time, the culture in the firm may also play an important role to characterize a firm as a start-up. After the start-up stage, the firm may grow further, remain stable, or disappear from the scene, taking the entrepreneur with it.

A serial entrepreneur starts his own firm, and then, after some time, leaves his firm behind and later starts another firm. This leaving behind may take different forms, for example, the firm may be sold to another party, the firm may be liquidated, or the firm may have gone bankrupt (see also the exit strategies in Section 1.5.2 in this book). After leaving behind the old firm, the serial entrepreneur starts a new firm, possibly directly after leaving the old firm or after an intermezzo of some time. It is also possible that this pattern of leaving and starting repeats several times, but this is not necessarily the case. The consecutive firms do not necessarily operate in the same sector.

A portfolio entrepreneur is someone who starts his own firm, and later starts another firm while maintaining the old firm as well. Both firms are hosted under the same umbrella, in a concern. The main difference with the serial entrepreneur is that the portfolio entrepreneur maintains the old firm and puts the old firm under an umbrella together with the new firm, whereas the serial entrepreneur in fact replaces the old firm by the new firm (possibly with a time interval). Again, the same as with serial entrepreneurs, this pattern may repeat several times, but this is not necessarily the case. And also again, the consecutive firms are not necessarily in the same sector. Iconic examples of portfolio entrepreneurs are Richard Branson with his Virgin Group and Stelios (Haji-Ioannou) with his EasyGroup, also called the Easy family of brands.

A former entrepreneur is a person who once ran his own firm but does not do so anymore. The reasons why he stopped with his firm may be different: for example, because he has sold his firm, because he went bankrupt or because he was retired. The main difference with serial entrepreneurs and portfolio entrepreneurs is that the former entrepreneur did not start another firm after his initial one. However, with his experience, the former entrepreneur can be a useful advisor (or coach or mentor) to, for example, nascent entrepreneurs and new entrepreneurs, as they lack entrepreneurial experience in general, which can be compensated by the experience of the former entrepreneur.

A gazelle entrepreneur represents a rapid or even extremely rapid growing firm (especially when shown over a longer period of time.) The gazelle firms, and therefore the gazelle entrepreneurs as well, are of great importance for the society, as they represent a large economic impact and as they create lots of jobs, both directly and indirectly (e.g., with suppliers). One good example of a gazelle entrepreneur is Mark Zuckerberg (Facebook), now representing one of the largest firms in the world (listed at the New York Stock Exchange since 2012, with a market value exceeding 500 billion USD in 2017, but 20 years ago he was virtually unknown to the general public). See also Section 1.5 of this book for gazelle enterprises.

A stable entrepreneur represents a firm that hardly grows nor hardly shrinks: his firm remains more or less at the same size level for a longer period of time. Although firm growth is an almost everlasting theme in entrepreneurship literature, in policy-making and in politics, a large part of small businesses in general hardly grow, and hardly shrink as well, while they remain healthy firms with great options for continuity. This absence of firm growth may even have nothing to do with the economic circumstances, although it may be expected that in times of poor economic conditions less firms grow than in times of good economic conditions. A stable entrepreneur may deliberately choose not to grow with his firms, for example, because he wants to stay independent from others or because he thinks that his role in a larger organization is less attractive for himself than his role in a smaller organization. However, it is also possible that a firm does not grow because the entrepreneur is not able to create firm growth or because the market does not allow the firm to grow.

Next to these seven main types, 11 other types of entrepreneurs can be distinguished: accidental entrepreneurs (people who did not consider to start their own firms but in the end started their own firms), hybrid entrepreneurs (people who start or operate their own firms while keeping their jobs in paid employment), lifestyle entrepreneurs (people who make their firms dependent on the lives they live and/or the lives they want to live, and who do not make their lives dependent on the firms they run), criminal entrepreneurs (people who operate outside the boundaries of the law, completely or in a gray zone: partly legal, partly illegal), sustainable entrepreneurs (people who work according to the profit-people-planet principle, see also Section 1.3 of this book), social entrepreneurs (people who deliberately contribute to a better world with their firm, on a commercial basis), and studentrepreneurs[4] (an abbreviation of student entrepreneurs: people who operate their own businesses even during their studies). Also, employees (so people not running their own business) may claim their role of entrepreneurial fame, like corporate entrepreneurs (employees in the private sector), academic entrepreneurs (employees at universities), publicpreneurs (employees in the public sector), and governpreneurs (employees in the government).

And then there used to be traditionally also ample attention for female entrepreneurs in the entrepreneurial literature. However, this is somewhat dated nowadays, especially in the Western world, as a female entrepreneur is more or less as normal as a male entrepreneur, and not a kind of rare phenomena anymore.

[4]This term is coined by Kathelijne Voets, who first used this term in her master thesis, called Studentrepreneurs […] studying at universities: an explorative study about the reasons & backgrounds, opportunities, obstacles, and success factors of student entrepreneurs (Vrije Universiteit Amsterdam, December 2010).

Further, there used to be ample attention for ethnic minority or immigrant entrepreneurs in the Western world. This is also somewhat dated nowadays, as the next generations of the former immigrants underwent their formative years in the Western world, thus evaporating former artificial barriers in society.

With this long oversight of different types of entrepreneurs, it may seem that almost everybody is an entrepreneur or at least that almost everybody shows entrepreneurial behavior. This is basically true, if you look at the definition of entrepreneurship: next to owner-managers of firms, any employee has to do with "creation, discovery, and exploitation of value-adding opportunities."

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## 1.7. Different Roles of the Entrepreneur[5]

*The three different roles that an entrepreneur can play are the subject of this section: professional, leader, and manager. These three roles are connected to the life cycle of the firm in the second part of this section.*

People show sets of behaviors that can also be seen as the roles that people play or the functions that people exercise. So do entrepreneurs as well. Basically, an entrepreneur may play three different entrepreneurial roles in and for his firm: (1) he may play the role as a professional, (2) he may play the role as a

[5]This section is partly based on Kwakkel, Masurel, and Van der Kaaden (2000), co-authored by the author of this book.

leader, and (3) he may play the role as a manager. In practice, entrepreneurs will most likely play combinations of these three different entrepreneurial roles, with different centers of gravity. Metaphorically, it could be said that that an entrepreneur has three brain hemispheres: professionalism, leadership, and management. First, we will mainly stick to these separate three entrepreneurial roles: the professional, the leader, and the manager. Second, we will focus more on the blending of the three entrepreneurial roles.

As a professional, the entrepreneur works directly on the job and also takes care of the sales directly, like a painter who is painting the exterior of a house and acquires new assignments for similar houses to be painted. Other areas of interest under this entrepreneurial role may be quality control (e.g., to use the right sort of paint or to use the right sort of brushes, in the example of the painter) and keeping up to date with developments in the profession (e.g., to know about new sorts of paints or brushes that have come on the market, in the example of the painter).

As a leader, the entrepreneur gives direction to the development of his firm and also formulates the long-term goals of his firm, like a painter who is deciding to paint the exterior of houses only or to paint also the exterior of, for example, factories, and who also determines the portfolio of objects to be painted. Another important activity of the leader entrepreneur may be the carrying out of SWOT analyses of the firm (S = current internal strengths of the firm, W = current internal weaknesses of the firm, O = future external opportunities to the firm, and T = future external threats to the firm).

As a manager, the entrepreneur takes care that the employees of his firm come into daily action and that they do the right things, like an employer-painter who divides the jobs among the employees-painters and takes care that the right kinds of paint and brushes are used by his employees. Other activities of the entrepreneur in the management role is to control and to solve conflicts, both within the firm and in relation of the firm toward stakeholders, and to create platforms for decision-making at the firm-level. A specific aspect of this management role is financial management: often this subject is undervalued in terms of importance and overvalued in terms of complexity.

So, on the one hand, in theory, these three entrepreneurial roles can be clearly distinguished from each other. A professional entrepreneur as such is not typically a leader entrepreneur, and neither typically a manager entrepreneur. This is similar to the presumptions that a leader entrepreneur in itself is not typically a professional entrepreneur nor a manager entrepreneur, and that a manager entrepreneur as such is not a professional entrepreneur neither a leader entrepreneur. On the other hand, in practice, these three entrepreneurial roles cannot fully be separated from each other, because a professional entrepreneur also to a certain extent may be a leader entrepreneur and/or a manager entrepreneur as well as that a leader entrepreneur also to a certain extent may be a professional entrepreneur and/or a manager entrepreneur as well as that a manager entrepreneur also to a certain extent may be a professional entrepreneur and/or a leader entrepreneur. Next to that, it can also be normative, in the sense that a professional entrepreneur also to a certain extent should be a leader entrepreneur and/or a manager entrepreneur as well as that a leader entrepreneur also to a certain extent should be a professional entrepreneur and/or a manager entrepreneur, as well as that a manager entrepreneur also to a certain extent should be a professional entrepreneur and/or a leader entrepreneur. The compromise between the theoretical angle and the practical angle of exercising different entrepreneurial roles is that the entrepreneur will be predominantly a professional or a leader or a manager, without fully wiping out aspects of the other two entrepreneurial roles. Certain subactivities named under the headings of the three entrepreneurial roles in previous paragraph may not be restricted to the main entrepreneurial role: a professional entrepreneur may also give direction to his firm, a leader entrepreneur may also work directly on the job, and a manager entrepreneur may also carry out a SWOT-analysis of his firm.

It is important, however, to realize that the role of the entrepreneur and the development of stages of the firm are interconnected. In other words, the role of the entrepreneur is a dynamic one, like the firm is, not a static one. If the characteristics of both the entrepreneurial roles and the life cycle of the firm are taken for established, then the following three propositions can be defended. First, in the start-up stage, the entrepreneurial role of the professional is the most important one. In this stage, the owner-manager is often the only employed person at the firm, or one of the few employed persons, and still the daily work has to be done. In the growth stage, the entrepreneurial role of the leader is the most important one, as, in this stage, the entrepreneur has to make important choices about the future development of his firm. In the maturity stage, as the entrepreneur has attracted a number of employees, the entrepreneurial role of the manager is the most important one. In the decline stage, the situation is somewhat more complicated, as it is often a stage in which the firm is seriously in jeopardy and is busy with ceasing operations. In principle, however, the entrepreneurial role of the professional is the most important one in this stage, as the entrepreneur is one of the few remaining employed persons or even the only employed person left, and still the daily work has to be done. In this sense, the decline stage is quite similar to the start-up stage, also in terms of firm size.

When talking about one person taking up different consecutive entrepreneurial roles during the life cycle of the firm, it is also the question whether one person can exercise different entrepreneurial roles in the course of time, even in his life. Not every professional is able to play the entrepreneurial role of a leader and a manager, and not every leader is able to play the entrepreneurial role of a manager. Next to that, it is also the question whether the entrepreneur likes to play different entrepreneurial roles in the course of time. Not every professional likes to become a leader or a manager, and not every leader likes to become a manager, even within his own firm. The required change of entrepreneurial roles may make the entrepreneur even an unhappy person, with all its consequences.

In particular in the transfer periods between the stages during the life cycle of the firm, the three roles of the entrepreneur may not be as black and white as they are in the separate stages. So, anticipating on the growth stage, the entrepreneur in the start-up stage, who should be mainly a professional then, may already take more the entrepreneurial role of a leader, which is the main role of the entrepreneur only in the growth stage of the firm. And when anticipating on the maturity stage, the entrepreneur in the growth stage, who should be mainly a leader, may already take more the entrepreneurial role of a manager, which is the main role of the entrepreneur only in the maturity stage of the firm. And when anticipating on the decline stage of the firm, the entrepreneur in the maturity stage, who should be mainly a manager, may already take more the entrepreneurial role of a professional, which is the main role of the entrepreneur only in the decline stage of the firm.

Finally, it should be mentioned that the actual set of roles that the entrepreneur takes may be different from the set of entrepreneurial roles that the entrepreneur wishes to take, consciously or unconsciously. The change from the actual situation to the wished situation may be too much for the entrepreneur alone to take. Support from an involved outsider or from a consultant may be helpful here.



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## 1.8. Entrepreneurial Competences

*The personal attributes that one needs to be successful as an entrepreneur are dealt with in this section: nine are standard (need for achievement, risk-taking propensity, tolerance for ambiguity, internal locus of control, self-efficacy, goal setting, independence, drive, and egoistic passion) and seven are additional (empathy, social commitment, team spirit, patience, perseverance, imagination, and emotional stability).*

According to the *Oxford Dictionary*, a competence ("in doing something/to do something") is described as "being able to do something well." A competence can in a certain sense also be seen as a trait, which is described by the *Oxford Dictionary* as "an element in someone's personality" or "a distinguishing characteristic." For this book, the self-developed definition of an entrepreneurial competence by the author is a necessary personal attribute that one has to have in order to be successful as an entrepreneur. This definition can even be extended to the degree into which the entrepreneur has to have a certain entrepreneurial competence. There are even schools of thought that use the word motivation for competence or for trait, but these approaches are rejected for this book. In a number of occasions, the word competency is used instead of competence.

In principle, the words competence and competency can be seen as synonyms, with the additional knowledge that both words refer to the common adverb competent.

A long list of entrepreneurial competences can be distinguished. The next enumeration of nine entrepreneurial competences is greatly based on the seminal list presented by Shane, Locke, and Collins (2003), although these authors mentioned these entrepreneurial competences entrepreneurial motivations in their paper (this is one good illustration of ambiguity in the field of entrepreneurial competences). Two major adjustments to the list by Shane et al. (2003) have been made by the author of this book: risk-taking is replaced by risk-taking propensity and locus of control is replaced by internal locus of control. The connecting brief descriptions of these nine entrepreneurial competences, respectively, were made by the author of this book:

(1) Need for achievement: the personal commitment of the entrepreneur to succeed in reaching a certain position with his business process.
(2) Risk-taking propensity: the tendency of the entrepreneur to get into business situations that can end up negatively.
(3) Tolerance for ambiguity: the ability of the entrepreneur to live with situations without clear outcomes for his business process.
(4) Internal locus of control: the believe of the entrepreneur that his own actions affect the outcome of his business process.
(5) Self-efficacy: the personal trust of the entrepreneur that the goals that he has set for his business will be met.
(6) Goal setting: the ability of the entrepreneur to set realistic and feasible goals in his business process.
(7) Independence: the entrepreneur takes his own judgments as decisive in making his business decisions.
(8) Drive: the willingness of the entrepreneur to put forth effort and to deliver energy in the business process.
(9) Egoistic passion: the entrepreneur's wishes to be in the spotlight personally and/or with his business.

Next to these nine more or less standard entrepreneurial competences, other entrepreneurial competences can be distinguished as well. This addition to the more or less standard list is based on the thoughts of the author of this book, on his discussions with students in the class room, with experts in the field of entrepreneurship and with entrepreneurs themselves, and on additional reading within and outside the field of entrepreneurship. This additional list contains seven entrepreneurial competences:

(10) Empathy: the ability of the entrepreneur to image and to share other persons' feelings and experiences in his business process.
(11) Social commitment: the motivation of the entrepreneur to contribute to a better world with his business.

(12) Team spirit: the willingness of the entrepreneur to act for the good of his business team and not so much his own interest alone.
(13) Patience: the ability of the entrepreneur to accept delay, annoyance or suffering within his business process.
(14) Perseverance: the continued steady effort of the entrepreneur to achieve his aim with his business process.
(15) Imagination: the ability of the entrepreneur to be creative and to think of new ideas in and for his business process.
(16) Emotional stability: the ability of the entrepreneur to find a balance among his private emotions and his business emotions.

These 16 (nine plus seven) entrepreneurial competences are often partially overlapping. For example: risk-taking propensity and tolerance for ambiguity do partially overlap: if an entrepreneur would not be able to deal with uncertain outcomes, then he would not be very much inclined to take risks. Another example of partial overlap between entrepreneurial competences is the one between drive and perseverance, as both entrepreneurial competences point at the importance of continuously putting effort in the business process by the entrepreneur. A third example of partial overlap between entrepreneurial competences is about the overlap between empathy and team spirit: in order to act for the good of his team, the entrepreneur should also be capable to image and to share the feelings and experiences of his team members.

The 16 entrepreneurial competences are not mutual exclusive, they often come together. When dealing with the determinants of entrepreneurial success, it is not so much about the effect of a single entrepreneurial competence on this entrepreneurial success but it is more about the effect of a set of entrepreneurial competences on this entrepreneurial success. It can even be reasoned that different combinations of entrepreneurial competences are required in different contexts and for different ambitions. If the context is hostile and dynamic, then other entrepreneurial competences may be needed compared with a context that is peaceful and static. Further, an entrepreneur who has great ambitions to become rich may need other entrepreneurial competences than an entrepreneur who wants to distinguish himself in social way or in an environmental way.

Finally, it should be noted that this list of 16 entrepreneurial competences is definitely not a final one: without any doubt more entrepreneurial competences can and will be distinguished in the future and will be added to this list in the future. An illustration of this is the recent addition of emotional stability to the list of entrepreneurial competences. This was done on the occasion of studying the behavior of the so-called lifestyle entrepreneurs by the author of this book, who make their role as an entrepreneur dependent on the life they want to live, and not vice versa as it is often the standard with entrepreneurs. And the list of entrepreneurial competences will never be final, it is a dynamic list, with additions continuously.

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## 1.9. Entrepreneurial Motivation

*The two main different forms of distinction of entrepreneurial motivation are dealt with in this section: opportunity-driven versus necessity-driven. They are connected to pull factors and push factors for the entrepreneurs.*

In general, behavioral motivation can be seen as the reason or the reasons why a human being behaves like he does behave. Three of the most basic behavioral motives or reason(s) for behavior of people are greed, love, and fear. If someone is greedy, then that person will try to get as much as possible of something, probably even at the cost of other persons. If someone loves another person, then the first person will most probably cherish the other person and possibly even protect the other person. If someone is in fear, then this person will most likely try to protect himself, for example, by being aggressive against those who threaten him. So, the behavior of an individual is to an important extent determined by his motivation to behave in a certain way. However, the connection from behavioral motivation to actual human behavior always takes place within the limitations of personal constraints and/or external constraints.

Considering the above-mentioned basic behavioral motive of fear and the relationship with external constraints, the next example can be given. If a person is in fear, then he may want to run away from the frightening situation; however, there should also be room for him to run away, if he wants to run away, otherwise he is simply not able to run away. Another behavioral response to the exposure to fear may be to protect himself against the fear, but then the tools or weapons should be available from the external environment for that purpose; otherwise, he cannot protect himself. Considering the earlier mentioned common motive of love and the relationship with personal constraints, the next example can be given. If a person loves another person, and he wants to cherish that other person, then he should also be able to express his feelings. Considering the earlier mentioned common motive of greed and the relationship with personal constraints, the next example can be given. If a person wants to become rich by trading Bitcoins, then he should also be able to understand how the market processes with Bitcoins work and how his stakeholders behave.

In entrepreneurship, when motivation is concerned, it is most common to distinguish between so-called pull factors and push factors. In the entrepreneurship literature, pull factors and push factors especially have been applied to the start-up process of the firm and to the decision of a person to become an entrepreneur or not. However, pull factors and push factors may be attached to the majority of decisions of the entrepreneur, also after the nascent stage and also after the start-up stage. In principle, pull factors and push factors play a vital role all during the whole life cycle of the firm, even until the expiration of the firm.

Pull factors can in general be described as drivers that lure individuals because of opportunities that are found attractive by these individuals. Examples of pull factors in the context of entrepreneurship are: the strive for personal autonomy, the wish for a higher income, the need to fulfill challenges, the aim for recognition, and the want to contribute to a better world. Exploiting these opportunities may bring the entrepreneur to the next level in his entrepreneurial existence. Pull factors in general can be interpreted as positive motivations: in principle, entrepreneurs choose freely to behave in this way, above available other alternatives, because they are attracted to the opportunities and they are driven to come to the next level of their existence.

Push factors, however, can in general be described as drivers that put pressure on the individual to move away from his current situation because he believes he will be better off in another situation that is more advantageous or less disadvantageous to him. Examples of push factors in the context of entrepreneurship are as follows: the strive to move away from unemployment, the fear for future unemployment, the wish to escape from poverty, the escape from discrimination in the workplace, and the experience of limitations in the field of professional promotion. This moving away from the unwished situation may also bring the entrepreneur to the next level in his entrepreneurial existence, even also more advantageous or less disadvantageous than before, more or less similar to what pull factors can do with an entrepreneur. Push factors in general can be interpreted as negative motivations: it is as such not the free choice of the entrepreneur but it is the current situation that is less attractive than the alternative, which drives him toward the new situation.

The difference between pull factors and push factors in the context of entrepreneurship is in line with the distinction between opportunity-driven entrepreneurs and necessity-driven entrepreneurs. The opportunity-driven entrepreneurs are more agitated by the favorable circumstances that they perceive or perceived whereas the necessity-driven entrepreneurs are more agitated by the current situation that is not attractive. So opportunity-driven entrepreneurship has to do with pull factors whereas necessity-driven entrepreneurship has to do with push factors.

Entrepreneurial motivation is not either strictly opportunity-driven or strictly necessity-driven, but entrepreneurial motivation is normally a combination of both pull factors and push factors. It is more likely to distinguish between entrepreneurs who are relatively more opportunity-driven than necessity-driven versus entrepreneurs who are relatively more necessity-driven than opportunity-driven. And even within the respective domains of opportunity-driven and necessity-driven, it is most often a combination of factors. So, as an example, an entrepreneur may be driven by a combination of mainly striving for autonomy and less important generating a high income, even in combination with a certain fear for unemployment in the near future and experiencing discrimination in the current situation. It is also possible that the motivation of the entrepreneur changes during the life cycle of the firm: one may start his firm for necessity reasons but during the life cycle of the firm, this person may feel more like driven by opportunity reasons, for instance because he has become more successful than before. This phenomenon is called fluid entrepreneurial motivation.

Finally, it is important to realize that entrepreneurial motivation is often a matter of personal perception (in the sense of a personal way of interpretation) and/or personal expectations of what will happen in the future, all by the entrepreneur himself. As an example, somebody may start his own firm because he thinks he will be unemployed in the near future, although this fear may not come out (or one will never know). Or, as another example, somebody may start his own firm because he thinks it will make him rich, although it may end in a bankruptcy with high personal debts in the end.

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## 1.10. Entrepreneurial Behavior

*The current three main different approaches in the identification of entrepreneurial behavior are dealt with in this section: discovery and creation, entrepreneurial orientation, and effectuation and causation.*

In the rich history of thinking about entrepreneurship, numerous studies have been made to catch and to understand the behavior of entrepreneurs. Currently, the most prominent approach to catch and to understand entrepreneurial behavior of entrepreneurs is known as the distinction between causation and effectuation. Until recently, however, much attention was also paid to the distinction between discovery and creation and to entrepreneurial orientation, in order to catch and to understand entrepreneurial behavior. These three approaches (discovery and creation, entrepreneurial orientation, and causation and effectuation) form the subjects of this section on entrepreneurial behavior. It goes without saying that these three approaches overlap but do not exclude each other.

Discovery and creation have directly to do with the concept of entrepreneurial opportunities, the subject that has been dealt with before in this chapter (even yet in Section 1.1). A seminal work about the distinction between discovery and creation is the paper by Alvarez and Barney (2007). Before the exploitation of the entrepreneurial opportunities can even start, which is done by the entrepreneur, these entrepreneurial opportunities have to be found by the entrepreneur. Then the main question is here: are entrepreneurial opportunities just out there, to be discovered by the entrepreneur, or are entrepreneurial opportunities not just out there and do they have to be newly created by the entrepreneur? In the case of the discovery of the opportunities, apparently the opportunities already existed, but they only had to be applied by the entrepreneur in a new context. One metaphor here is the discovery of America by Christopher Columbus in 1492 (well, he thought he had discovered a new route to the Indies, but that is another story). The continent of America already existed, but, thanks to its discovery, it could be brought into the global system of those days, say it was applied in a new context. So, in terms of Alvarez and Barney (2007), this entrepreneurial opportunity already existed, independent of the perception by Christopher Columbus. In the case of the creation of the opportunities, the opportunities are brought forward by the entrepreneur, as they did not exist yet. In fact, the entrepreneur creates his own market with the creation of opportunities. Creation of opportunities is closer to radical innovation whereas discovery of opportunities is closer to incremental innovation (see also Section 1.2. of this chapter).

Alvarez and Barney (2007) distinguished seven entrepreneurial actions in which differences between discovery and creation can be distinguished. Although these seven entrepreneurial actions may be considered as rather arbitrary, they are listed below (including an indication of the main differences, again according to these two authors):

(1) leadership (under discovery, leadership is based on expertise and experience versus under creation, leadership is based on charisma);
(2) decision-making (risk-based data collection tools, risk-based decision-making tools and importance of opportunity costs under discovery versus iterative, inductive, incremental decision-making, use of biases and heuristics, and importance of affordable loss under creation);
(3) human resource practices (both discovery and creation are expressed here in terms of recruitment: specific human capital recruited broadly under discovery versus general and flexible human capital recruited from preexisting social networks under creation);
(4) strategy (relatively complete and unchanging under discovery versus emergent and changing under creation);
(5) finance (external capital sources, banks, and venture capital firms under discovery versus bootstrapping, family, friends, and fools under creation);
(6) marketing (changes in the marketing mix may be how new opportunities manifest themselves under discovery versus the marketing mix may fundamentally change as a result of new opportunities that emerge under creation); and
(7) sustaining competitive advantages (speed, secrecy, and erecting barriers to entry may sustain competitive advantages under discovery versus tacit learning in path dependent processes may sustain competitive advantages under creation).

However, two important observations can be made with the discovery and the creation of entrepreneurial opportunities. First, this distinction between discovery and creation is more a conceptual approach, with two extremes that may be sensible to distinguish in theory but that in practice may be hard to distinguish or maybe even not at all. The second important observation is that the distinction between discovery and creation primarily may have to do with perception by the entrepreneur, and not so much with the objective truth. For example, the discovery of America by Christopher Columbus in 1492 was perceived by many people as a an act of creation, because the continent was new to them, but, in fact, the continent was not new and already existed for a long time, and thus the activity of Christopher Columbus was more an act of discovery than an act of creation.

The second approach of entrepreneurial behavior in this section is entrepreneurial orientation. Many descriptions of entrepreneurial orientation exist. According to the *Oxford Dictionary*, orientation is "the action of orientating oneself or the state of being orientated," whereas to orientate oneself is described in the *Oxford Dictionary* as "to establish one's position in relation to one's surroundings." Therefore, entrepreneurial orientation, for this book, can be seen as to place oneself in his environment as an entrepreneur. The popularity of the subject of entrepreneurial orientation started more or less with the seminal paper by Miller (1983), after which a number of operationalizations of entrepreneurial orientation have taken place. In the original work by Miller (1983), the focus was on pioneering, innovation, and risk-taking. Overlooking the field, probably the most frequent used approaches of entrepreneurial orientation are as follows:

(1) Risk-taking: this dimension involves undertaking activities which involve risk, or put in another way, activities with outcomes that are uncertain and may lead to losses (next to the option that the activities may lead to profits, even excessive profits).
(2) Innovativeness: this dimension implies a positive inclination toward new ideas concerning new products and services, new production processes, new markets, new inputs, new organizational forms, or new brands. See Section 1.2 in this book for more information on innovation in relation to entrepreneurship.
(3) Pro-activeness: this dimension stands for forward-looking, anticipation on events in the future or creating a situation by causing things to happen. The opposite of pro-activeness is re-activeness, in which the response to events is most important.
(4) Competitive aggressiveness: in this dimension, it is about the aim of the entrepreneur to outperform competitors by attacking them, directly or indirectly, deliberately or non-deliberately. The aggressive entrepreneur typically relies on an offensive approach rather than a defensive approach.
(5) Autonomy: this dimension is about the strive to have control over one's own destiny. This dimension is closely related to the entrepreneurial competence of independence (see Section 1.8 of this chapter), in which the entrepreneur takes his own judgments as decisive in making his business decisions.

The main alternative approach to creation and discovery and to entrepreneurial orientation to catch and to understand the behavior of entrepreneurs is the distinction between causation and effectuation. The seminal work about this distinction between causation and effectuation is by Sarasvathy (2001). In short, she considers that causation processes take a particular effect as given and that causation processes focus on selecting between means to create that particular effect. However, she considers that effectuation processes take a set of means as given and that effectuation processes focus on selecting between possible effects that can be created with that set of means. The metaphor in this context is the preparation of, for instance, minestrone soup (this metaphor is partly based on the metaphor of the thought experiment by Sarasvati, called curry in a hurry). With the causation approach, the minestrone soup is on the set menu of a restaurant and the decision is in acquiring the right ingredients for the soup (like carrots, onions, and olive oil). With the effectuation approach, ingredients for minestrone soup are available in the kitchen, and not enough ingredients for any other soup, and therefore, minestrone soup is put on the menu of the day, sometimes even a variation in the traditional minestrone soup.

Sarasvathy (2001) distinguished seven "categories of differentiation" between causation processes and effectuation processes. Although these seven categories may be considered rather arbitrary, they are listed below (including an indication of the main differences):

(1) givens (the effect is a given under causation versus only some means or tools are given under effectuation);
(2) decision-making selection criteria (causation helps to choose between means to achieve a given effect versus effectuation helps to choose between possible effects that can be achieved with given means; selection criteria based on expected return under causation versus selection criteria based on affordable loss or acceptable risk under effectuation; effect-dependent under causation versus actor-dependent under effectuation);
(3) competencies employed (excellent at exploiting knowledge under causation versus excellent at exploiting contingencies under effectuation);
(4) context of relevance (more useful in static, linear, and independent environments under causation versus explicit assumption of dynamic, non-linear, and dependent environments under effectuation);
(5) nature of unknowns (focus on the predictable aspects of an uncertain future under causation versus focus on the controllable aspects of an unpredictable future under effectuation);
(6) underlying logic (to what extent can we predict the future and control it under causation versus to what extent can we control the future but we do not need to predict it under effectuation); and
(7) outcomes (market share in existent markets through competitive strategies under causation versus new markets created through alliances and other cooperative strategies under effectuation).

Nowadays, several alternative popular approaches of effectuation versus causation can be identified. Two of the most important approaches can be mentioned here. First, Brettel, Mauer, Engelen, and Küpper (2012) distinguished four differences between effectuation and causation: means-driven versus goals-driven (effectuation concerns creating entrepreneurial activities based on the means available whereas causation starts with targets and then identify the required means to achieve these targets), affordable loss versus expected returns (effectuation considers the potential losses from entrepreneurial activities versus causation considers expected returns from entrepreneurial activities), partnerships versus competitive analysis (effectuation implies reducing uncertainty by establishing partnerships while causation implies reducing risks by competitive analysis), and acknowledge the unexpected versus overcome the unexpected (effectuation involves dealing with unexpected events as a source of opportunity while causation represents a linear process that seeks to realize the business plan efficiently).

Second, Chandler, Detienne, McKelvie, and Mumford (2011) outlined four principles that differentiate causation and effectuation approaches: a focus on short-term experiments to identify business opportunities in an unpredictable future (effectuation) versus prediction of an uncertain future by defining the final objective upfront (causation), a focus on projects where the loss in a worst-case scenario is affordable (effectuation) versus maximization of expected returns (causation), an emphasis on pre-commitments and alliances to control an unpredictable future (effectuation) versus business planning and competitive analysis to predict an uncertain future (causation), and exploitation of environmental contingencies by remaining flexible (effectuation) versus exploitation of preexisting capabilities and resources (causation).

However, an important observation can be made with the distinction between causation processes and effectuation processes. Basically, it is not so much new, because it relates very much to the discussion on the use of formal business plans by entrepreneurial firms and the role that the environment of the firm plays for the use of these formal business plans. There is also a considerable overlap with the creation and discovery approach and with entrepreneurial orientation. The main issues in the distinction causation and effectuation is that in a stable environment (see above-mentioned "context of relevance") a causation approach may work better because the effect is more given (see "givens") and that in a dynamic environment (see again above-mentioned "context of relevance"), an effectuation approach may work better because the effect is not so much given, only some means or tools are given (see again "givens").

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## 1.11. Small Business Finance

*The way in which entrepreneurs finance their small firms is the subject of the final section of this chapter. The traditional different forms of small business finance are distinguished in this section (debt finance and equity finance), but attention is also paid to bootstrapping, that is very relevant for small firms. Attention is also paid to the financial report and to the financial plan.*

Next to the input of labor in the entrepreneurial process of small businesses, the role of financing the small firm deserves ample attention, or in other words, the input of financial capital in the entrepreneurial process of small businesses, for this book. The first step in dealing with this subject is noting that the traditional main difference in entrepreneurial finance (viz. debt finance versus equity finance) also applies to small businesses.

Debt finance consists of loans from one or more external parties to the firm, which results in a debt position (also called debts) for the firm. One traditional form of debt finance is the loan from the commercial bank to the firm, for which, normally and periodically, payments have to be made back to the bank (in the form of interest and parts of the principal, in combination called installments). However, a long series of often related forms of debt finance can be distinguished, including the use of overdrafts from commercial banks and the exploitation of supplier credits (as a form of value chain finance). The common denominator in debt finance is that the debt has to be paid back to the financer, plus interest, within the agree repayment period.

For the awarding of a loan from a commercial bank to a businesses, at least four factors play a role of importance: (1) the business plan of the firm (in terms of, e.g., structure, completeness and feasibility of the business plan), (2) the entrepreneur as a person (in terms of, e.g., credibility and entrepreneurial competences of the entrepreneur, see also Section 1.8 of this book), (3) the collateral offered by the firm and/or the entrepreneur (e.g., the own house as a personal belonging of the entrepreneur or a relative who bails for the entrepreneur), and (4) the track record of the firm and/or the entrepreneur (also called previous experience).

Equity finance results in acquiring (part of the) the ownership of the firm. An important difference is made between internal equity and external equity. Internal equity can be in the form of personal investments of the owner-manager into the firm. Also investments of friends and family members of the entrepreneur can be included here, in exchange for a part of the ownership in the firm, and retained profits of the firm. External equity means that an outside party obtains part of the ownership of the firm, in other words, conversely, the original owner loses partly control of or say in his own firm. The entrance of an outside party into the firm may be combined with the issuing of extra shares by the firm, which means that the value of the existing shares dilutes. In principle, ownership of the firm is not refunded in direct financial compensation, but ownership of the firm is to be rewarded in the form of dividends and/or increasing value of the ownership in the firm. A firm owner may also decide to sell the ownership of the firm, or a part of the ownership in the firm, to an external person or organization: then he is refunded for his initial investment but then he also loses (partly) ownership in the firm.

A number of specific and actual subjects in the field of small business finance can be mentioned, the most prominent being nowadays the business angel, the venture capitalist, micro credits, and crowdfunding. Although there are many descriptions possible, the following brief descriptions in one sentence characterize these forms of small business finance quite well. A business angel is a wealthy individual, sometimes related to the entrepreneur, who invests in start-ups, in exchange for ownership in the firm. A venture capitalist is an organization that invests in the ownership of potentially high-growth start-ups, with accompanying high risks for the investor. A micro credit is a small-scaled form of debt finance, possibly accompanied by other forms of micro finance, for example, insurance and saving, in combination with weak requirements for collateral. Finally, crowdfunding is focused on a large number of investors (the "crowd"), all investing a small amount of money in the firm, be it with or without an intended compensation, be it financial or otherwise, often done via platforms on the internet.

As for most firms, it also applies to small firms that they often work with a combination of financial sources, not only both debt finance and equity finance, but also various forms within debt finance or/and various forms within equity finance. Next to these traditional forms of finance, for start-ups, it is also often pointed at bootstrapping as important form of financing the firm. Bootstrapping means that the owner-manager of the small firms is creative in small forms of alternative financing, varying from maximum use of the personal credit card to overdrafting on the personal bank account. Next to that, the entrepreneur of the small firm may minimize his need for finance, for example, by paying his suppliers late or by taking another (often part-time) job next to running his own firm or by sharing his assets with other entrepreneurs.

The financial situation of the firm is not a static one but a dynamic phenomenon. In Section 1.5 of this book, it was already dealt with how the financing of a firm may develop over time. The assumption was that the further the firm develops during the life cycle of the firm, the lower will be the assumed level of investment risk by investors. This assumption also has consequences for the financers of the firm. In the start-up stage, finance will mainly come from the entrepreneur himself and maybe from certain relatives, friends, and acquaintances. In the growth stage and in the maturity stage, formal financers may come in, like commercial banks and perhaps venture capitalists. In the decline stage, investors are expected to withdraw from the scene.

Connected to the financing of the small business, the financial report and the financial plan should be mentioned here. With the financial report, the entrepreneur informs his stakeholders about the financial consequences of operating his own business, such as the internal revenue service (or tax service) and his financers. The financial report may also give him proper insight into his own financial position.

The basic financial plan consists of three elements: the profit and loss statement, the balance sheet, and the cash flow statement. See Appendix 1 of this book, for a further elaboration on these three interconnected elements of the financial plan (and the breakeven analysis and the use of performance ratios). Additionally, see Appendix 2 of this book, for a practical application of the financial plan, about the fictive firm "Pizza Pete").

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