

HOW CAN ASSISTANCE PROGRAMS CREATE VALUE FOR ENTREPRENEURS?
A GROUNDED THEORY CASE STUDY OF THE MICHIGAN STATE UNIVERSITY PRODUCT CENTER
FOR AGRICULTURE AND NATURAL RESOURCES.

By

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ABSTRACT

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Entrepreneurial Assistance Programs (EAPs) have been in existence in the United States since the late 1970s. However, there has not been conclusive evidence that quantitatively measures the value that EAPs provide for their clients. The primary cause for this lack of conclusive evidence is due in part to measurement concerns such as sample selection bias and clustering effects, and in part because of the lack of strong qualitative research that has examined the mechanisms of how EAPs create value for their clients. This research, therefore, has been done in order to shed greater light on the question “how do EAPS create value for their clients?” through a qualitative grounded theory case study approach in order to provide a theoretical framework to address the question of “how much value do EAPS create?” in later research. This was done through using the entrepreneurial process framework developed by Shane (2003) to interpret the results arising out of a case study of one particular EAP: The Michigan State University Product Center for Agriculture and Natural Resources. The results of this research indicate that EAPs can create value for clients by improving their clients’ new venture’s probability of success and survival through: (1) providing a check on cognitive biases in the strategic decision-making process; (2) assisting in the development of strategy and competitive advantages; (3) assisting to legitimize the new venture; and (4) serving as a direct and as an indirect tie to service providers, resource holders and trading partners.

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I. **Introduction**

Entrepreneurship is often attributed to being one of the primary drivers of economic growth within a society (Knight, 1921; Schumpeter, 1934). One study suggests that nearly 70 percent of US economic growth has come from entrepreneurial activity (Reynolds et al, 2000). Despite the importance of entrepreneurship, however, the research shows that it is very difficult to for new ventures to survive in the marketplace, with over 50% of new ventures failing within the first five years (Cooper, Woo and Dunkelburg, 1988; Shane, 2008). In fact, In his book, *Illusions of Entrepreneurship: The Costly Myths that Entrepreneurs, Investors, and Policy Makers Live By*, Shane provides the chart shown in figure 1 (below) that depicts the survival rate of a cohort of entrepreneurs who all started new ventures in the year 1992 (Shane, 2008). The story this chart shows paints a pretty grim picture for nascent entrepreneurs with 25% failing in the first year, less than 50% still alive after five years and less than 30% after 10 years.

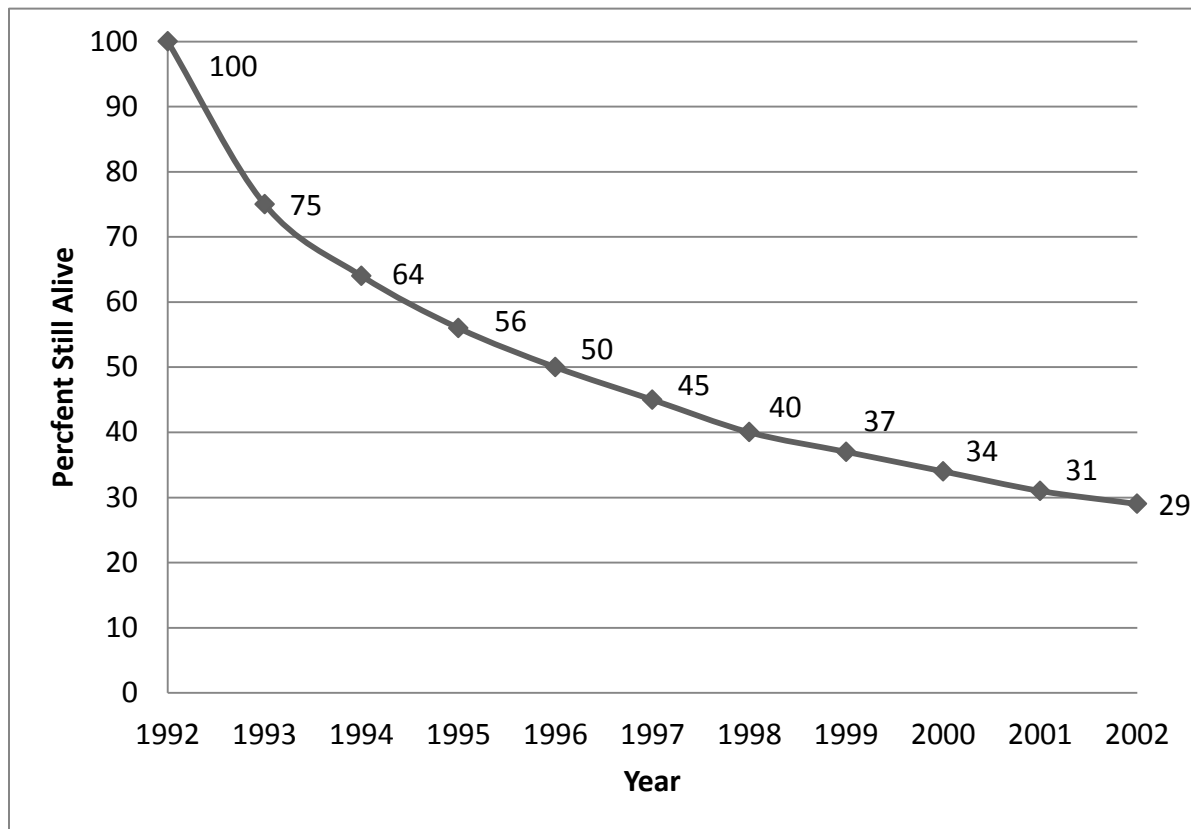


Figure 1: Start-up Survival Rates of 1992 Cohort (Shane, 2008)

This indicates the great degree of difficulty facing nascent entrepreneurs in engaging in entrepreneurial activity. These nascent entrepreneurs and their start-up organizations need, as stated by Yusuf (2010), “the right mix of capital and resources to succeed, in the absence of which they often look for external guidance and assistance.” Therefore, it should not be surprising that many entrepreneurial assistance programs (EAPs) have been founded to help support nascent entrepreneurs, growing from fewer than 10 such EAPs in 1987 to more than 200 in 1996 (Schreiner, 1999) and many more today.

EAPs, most often established through public financing, are entrepreneurial support centers whose goal is to aid prospective small business owners in new venture creation through providing pre-venture assistance (Chrisman, Hoy, Robinson, 1987). One of the most common and prominent examples of an EAP is the Small Business Development Center (SBDC). The SBDC was founded in 1977-78 by the Small Business Administration in cooperation with six states and the District of Columbia, and based on its early success, was expanded nationwide by Congress (Chrisman, Hoy, Robinson, 1987).

The literature suggests that EAPs such as the SBDC can positively impact on the formations of new ventures (e.g Clark et al., 1984; Stevenson and Sahlman, 1988; Solomon and Weaver, 1983; Robinson, 1982). However, these programs are not costless and often require significant financial and other resource commitments from EAP sponsors such as the state and federal governments as well as from the external EAP partners and service providers (Yusuf, 2010). Furthermore, the entrepreneurs receiving service will often invest a significant amount of time and energy working with the EAP. Therefore, evaluating EAP impact and effectiveness is important (Yusuf, 2010).

Past attempts at evaluating EAPs have used the entrepreneur's venture performance or satisfaction with the EAP as proxies for the value of the service provided (Yusuf, 2010; Chrisman, Hoy and Robinson 1987; Chrisman, 1998; Chrisman, McMullan 2000; McMullan, Chrisman, Vesper, 2001.). These studies, however, have not sufficiently taken into account the mechanisms by which the EAP can create value for a nascent entrepreneur within the context of the entrepreneurial process. Other concerns include the use of subjective measures, such as

client satisfaction with an EAP, that have been shown to be uncorrelated with actual business performance (McMullan, Chrisman and Vesper, 2001). As well as the fact that performance measures raise concerns about sample selection bias (Bartik, 1994; Storey, 2000; McMullan, Chrisman and Vesper, 2001) and will often be negatively correlated indicating a clear lack of a single performance construct (Murphy, Trailer and Hill, 1996). Instead, by examining the value an EAP can create within the context of the entrepreneurial process, such as is laid out by Shane (2003), a clearer picture of the mechanisms on how value is created can be ascertained.

Furthermore, each EAP client will have a unique utilization of the services provided that can vary from a single consultation on a particular issue to working with the EAP throughout the whole start-up process and beyond. To properly evaluate the value provided, therefore, one must take the level of engagement in a particular EAP activity into account and measure it against the ability of the entrepreneur to overcome a particular difficulty associated with a particular stage of the entrepreneurial process.

Few research studies have examined mechanisms by which EAPs create value for nascent entrepreneurs within the context of the entrepreneurial process. This study addresses this important issue and further examines the areas of the entrepreneurial process in which an EAP can have the most effect. Therefore, this paper will be an attempt to better understand the value EAPs create.

II. Entrepreneurial Assistance Programs background

A. Past Approaches at Evaluation of EAPs

In the early 1980s to the mid-1990s there was a prominent strand of research that measured the impact of EAPs in terms of comparing EAP clients to non-EAP clients on performance measures such as increase in sales, employments and profits (Robinson, 1982; Chrisman, Nelson, Hoy and Robinson 1983; and Chrisman, Hoy and Robinson 1987). In general, these studies found that EAP-clients outperformed their non-EAP counterparts. However, these studies often compared the performance of a small number of EAP clients (usually under 100) from high performing EAPs to state averages of entrepreneurship (e.g. Chrisman, Hoy and Robinson 1987). In addition, there does not appear to be any accounting for the selection bias that is inherent in the EAP process in terms of counselors discouraging entrepreneurs to continue with the new venture process if their ideas are perceived to be untenable.

In addition to performance measurement comparisons there have been other studies aimed at the subjective assessment of client satisfaction as a measure of the benefit of an EAP (Ibrahim and Goodwin, 1986; Solomon, 1983; Nahavandi 1988). These studies have found that EAP clients have, on average, rated EAPs positively. However, one study found no correlation between client satisfaction levels and the previously indicated performance indicators (McMullan, Chrisman and Vesper, 2001). Instead, they concluded satisfaction came more from the personal experience the client had with the counselor. More recently, Yusuf (2010) assessed EAPs based on client participation, satisfaction and entrepreneurs' subjective assessments of overall effectiveness. In regard to the last measure, Yusuf found that EAP

programs were effective at meeting the nascent entrepreneur's support need only 25.8% of the time. However, despite this lack of effectiveness, Yusuf still found that 96% of the surveyed clients found the assistance at least somewhat valuable, with 50% finding it extremely valuable (Yusuf, 2010). This high degree of satisfaction, yet unclear correlation to how the assistance actually improves the business also suggests deeper analytical research is required in order to uncover the mechanism of EAP impact on the success and survival of its clients' new ventures.

B. Problems with the past approaches

i Sample Selection bias and other endogeneity concerns

Despite the apparent positive influence of EAPs on client performance, the literature has left unanswered whether the observed increased success rate is robust to corrections for selection bias. On the one hand, some have suggested that the fact that an entrepreneur has sought assistance indicates the entrepreneur is likely having some problems with the launch of their new venture (e.g. Kusters and Obschonka, 2010). These problems could be due to a lack of business experience or entrepreneurial ability that in turn will affect the overall performance of the new venture. Therefore, any comparison of assisted entrepreneurs to non-assisted ones would have an inherent negative bias in its estimation if this sample-selection is not accounted for. On the other hand, the literature also suggests that entrepreneurs who are less committed, have untenable ideas, or have a variety of other issues that would impede their overall chance of success, tend to get "weeded out" in the first stage of the counseling process when counselors educate clients on the work involved and low probabilities of success (Storey, 2000; McMullan, Chrisman and Vesper, 2001). It is logical to suggest had the "weeded-out" group

continued on to launch their new venture, their overall probability of success would be lower than the general population of entrepreneurs. Conversely, the population that does continue on through the process is one that can be expected to have a higher probability of success, based on the quality of their idea or their willingness to put forth the appropriate effort, than the general entrepreneur population and hence would cause a positive duration bias on any estimations of the impact of assistance.

In addition to selection bias concerns, there is also a concern regarding the clustering of entrepreneurs. This occurs because entrepreneurs have a large degree of heterogeneity in their usage of EAPs (e.g. Kusters and Obschonka, 2010), which should lead to different clusters of intense users and casual users who will be impacted very differently by the EAP. The impact of the EAP on the casual users (i.e. someone who comes only once for a single service versus someone who works intensely with the EAP over the whole course of the entrepreneurial process) will be much smaller and harder to estimate compared to a control group of non-assisted entrepreneurs and may obscure the differentiation between the treatment and control.

In essence if one were to conduct a simple regression such as:

$$Y_i = X_i\beta + Z_i\gamma + \epsilon_i$$

Where Y denoted a particular performance variable, X was a vector of explanatory control variables and Z was a dummy variable indicating participation in an EAP with a corresponding β vector of coefficients to be estimated, then the concern would be some omitted variable, such as entrepreneurial ability or work ethic, might be omitted from the regression and hence cause Z to be endogenous. This is a concern because if entrepreneurial ability, business experience or work ethic influences the participation variable, as well as the performance

variable, then the estimator of interest (namely γ) would be correlated with the error term (which would include the omitted variable) and hence lead to inconsistent estimation (Wooldridge, 2002). Therefore, any study attempting to identify the impact of the EAP, without accounting for the sample-selection bias, the duration bias and the clustering effect will lead to biased results and hence undermine its own validity.

The existence of these measurement concerns makes empirical evaluation of the effect of the EAP problematic. That is to say, if one observes EAP clients as having a higher overall success rate on average, can this be attributed to the influence of the EAP or simply to the selection bias? This has led some researchers to claim that “evidence of growth or job creation (of EAP clients) without comparisons to a control sample matched on the basis of age, sector, ownership and geography, and with adjustments for selection bias do not provide a convincing case for economic impact” (from McMullan, Chrisman and Vesper, 2001; citing Bartik, 1994). These adjustments must account for factors that determine performance *and* the factors that predict selection (Bartik, 2004) in a manner that isolates the effect of the EAP from the effect the entrepreneur’s own skill set would likely produce. Bartik and Storey both suggest using something similar to the Heckman two stage estimation of Cragg’s double hurdle model (Bartik, 2004; Wren and Storey, 2002; Heckman, 1979) to account for selection bias. The double-hurdle model predicts participation in the first stage then uses the inverse-mills ratio obtained to account for selection bias in the second stage in the regression of interest (Heckman, 1979). In the case of EAPs, this would be very difficult to model unless one has sufficient data on both those who get decide not to seek assistance as well as those who get “weeded out,” that can lead to a prediction of both participating in the EAP and staying with the EAP program.

Obtaining this particular data has its own problems, however, as: (1) those “weeded out” often are not interested in responding to surveys on the organization (based on the author’s experience in trying to contact such clients); and (2) obtaining accurate objective measures such as sales or profits from small business entrepreneurs is often difficult as entrepreneurs do not like to give such information to researchers (Sapienza, Smith and Gannon, 1988).

In addition, a certain percentage of those entrepreneurs who continue on in the EAP process might not have discovered or decided to exploit the opportunity without the encouragement of the counselors or the access to the EAP’s network of resources. So not only are those with untenable new venture strategies being “weeded out” but those with tenable new venture strategies are being “planted in.” It is unclear how selection bias corrections would directly account for this. Also, given that EAPs often provide a lot of “basic” business knowledge and information, those with extensive business experience may be less likely to find the EAP useful enough to continue through the EAP process.

In relation to the negative effect, one study has attempted to control for this effect through propensity score matching (Kosters and Obschonka, 2010). In this instance, assisted entrepreneurs’ performance measures were compared to the weighted average of unassisted entrepreneurs’ performance measures, where the weights were determined by similarity between the propensity to seek assistance of the unassisted group with each assisted individual. The result found no significant differences between groups, however the independent variables used to model propensity to seek assistance found only lack of prior self-

employment, time since founding and novelty of the start-up to be significant positive predictors of seeking assistance (ibid).

It is not clear why simply controlling for these observables within a standard regression would not sufficiently control for the same influences that propensity score matching is attempting to control while still controlling for all other controls of interest that will be left out of the propensity score matching procedure. That is to say, by comparing solely on the basis of propensity to participate, one ignores the influence of factors that may not influence the participation decision but otherwise could influence performance. Furthermore, the question still remains whether or not this method has sufficiently accounted for the selection bias problem due to the unobserved influences of ability and work-ethic. Ideally, one would wish to have an instrumental variable that is correlated with participation but uncorrelated with performance to mitigate the influence of all selection bias factors (Wooldridge, 2002).

ii Issues with dependent variables

Aside from this issue of sample selection bias, determining what the appropriate performance measures to evaluate EAP clients on is also quite problematic. In fact, in a meta-analysis of 51 published papers (1987-1992) related to measuring entrepreneurial performance, Murphy, Trailer and Hill (1996) found no less than eight different performance dimensions used by researchers. Most of these relied on primary data, and no study contained more than five of the eight measures, while most focused on only one or two. These dimensions, in order of highest to lowest frequency of use were: Efficiency, Growth, Profit, Size, Liquidity, Success/Failure, Market Share, and Leverage. Murphy, Trailer and Hill then used Compact

Disclosure data from 1993 on nineteen performance variables from eight hundred and three firms to conduct an exploratory factor analysis (EFA) and found nine distinct factors that explained over 70% of the variance in performance measures, with no single factor explaining more than 14% of the total variance. Confirmatory factor analysis (CFA) was conducted and found that less than half of the intercorrelations of performance measures were significant and more than 25% of the significant correlations were negative, indicating a clear lack of a single performance construct validity (Murphy, Trailer, Hill, 1996). If there is significant variation in the intercorrelations of such measures, focusing on one or two alone as the basis for comparison, such change in gross annual sales or employment (as has been done in past EAP evaluations), without strong theoretical reasons for doing so, might obscure the actual impact the EAP is creating.

Furthermore, given that over 50% of new ventures fail (Cooper, Woo and Dunkelburg, 1988), for many, the ultimate decision for many will be to not pursue the venture at some stage. However, assuming one will ultimately decide not to exploit, if one can come to this decision early on the process the cost to the individual and society will be a lot less. Resources, such as personal time, finances, bank loans, supplies, workers' time, and so on, will not have been wasted on an economic dead end. Therefore, "success" for those who are pursuing "false leads" or who have overestimated their ability and desire to carry the venture through to fruition might be for the EAP counselor to convince the client to do something else. By removing this "self-selection" effect from evaluation of the impact of the EAP, one is removing one of the key components of the value provided by the EAP.

In all, this makes the use of entrepreneurial performance data alone as a measure of EAP impact quite problematic. This is not to say that performance measures are unimportant, but rather the evaluation of performance data needs to be more clearly defined in terms of how it will measure the impact the EAP is generating as well controlled for both selection-bias and the extent of use by the entrepreneur. Therefore, it should not be surprising that this sample selection bias difficulty combined with the lack of clear performance measures relevant to the assistance provided appears to have prevented many researchers from drawing significant further conclusions about EAP impact.

An approach that can address this issue is needed to continue to develop the literature on the benefits provided by entrepreneurial assistance programs. Therefore, new approaches must incorporate more than comparisons of EAP clients to their relevant industry counterparts as a sole measure of the impact of the EAP itself.

Finally, what is considered successful assistance will also depend on the goals of the entrepreneur receiving the assistance. In particular, not all entrepreneurs seeking assistance are “innovative entrepreneurs” or those who are in pursuit of achieving profits associated with the introduction of new products to the market, new means-end relationships or new markets for existing products. (Schumpeter, 1934, Shane 2003). Instead, there is a large subset of “lifestyle entrepreneurs” who are simply interested in working for themselves, doing something they love and achieving enough of a net surplus from their venture to sufficiently support themselves (e.g. Morrison et al, 1999).

This distinction is quite important because it changes the framework necessary for the evaluation of the EAP impact. In the case of the innovative entrepreneur, for it to be a true opportunity, as defined above, it must be possible for the entrepreneur to find a new combination of resources that provide greater returns than their associated economic rents. By contrast, for the lifestyle entrepreneur, the expected returns only need to be greater than a minimum threshold reservation utility required by the entrepreneur to support themselves despite potentially not surpassing their own time and labor's opportunity cost. This group is not seeking to generate any more profits than would be an adequate return to their own labor. In essence, for the lifestyle entrepreneur, the decision to start a new venture can be viewed as a utility maximizing vertical coordination strategy so long as the venture can provide enough of a return to overcome a minimum reservation utility.

This leads to a different metric in order to evaluate the effect of the assistance provided by an EAP for the lifestyle entrepreneurs versus the innovative entrepreneurs. For example, simple survival rates might be more indicative of success than increases in sales or employment. Therefore, performance data comparisons may be a poor measure of benefits received unless we can clearly distinguish and account for the desired performance for each entrepreneur.

While these past attempts at evaluation have captured some of the benefits provided, their reliance on performance and satisfaction data alone as the primary variables of interest fail to encapsulate the full value of EAPs. The entrepreneurial process is one characterized by risk, uncertainty and high failure rates with many nascent entrepreneurs dropping out of the

process even before the launch of a new product or service. Therefore, since the assistance provided by EAPs often involve a great deal of work before any performance variable such as gross annual sales even occur, measurement of the effectiveness of an EAP and the benefit that it provides must expand beyond (though not necessarily exclude) sales and other performance data.

Performance data only measures the small subset of entrepreneurs who persist to the launch of a new product and have remained in operation long enough to have sufficient sales and employment data. Undoubtedly, this group is quite important in terms of societal impact, but the benefit of preventing untenable strategies from engaging resources which could be better put to a different use should not be ignored. Furthermore, the reduction in transaction costs and information asymmetries that EAPs can directly facilitate, such as providing better access to networks of lenders, suppliers, distributors, co-packers and retailers, is also not very well captured in the comparison of performance or satisfaction data by themselves without a strong theoretical foundation as to what the appropriate performance measure should be in relation to the benefit provided by the EAP. Therefore, it is important to take into consideration the larger framework of the entrepreneurial process, such as the one presented by Shane (2003), in order to better understand the value that an EAP can create (see table 1, below, for a summary of EAPs measurement concerns).

Table 1: Measurement concerns in estimating the treatment effect of Entrepreneurial Assistance Programs

Measurement Concern	Cause of the Concern	Effect if unaccounted for
Selection bias	Those with more problems and less experience more likely to seek assistance.	Treatment effect of the participation variable will have a downward bias.
Duration bias	Those with higher work-ethic, quality of idea and entrepreneurial ability more likely to continue in the EAP process.	Treatment effect of the participation variable will have an upward bias.
Clustering of client utilization	Entrepreneurs will have a high degree of variation in their utilization of services into two distinct groups: casual and intense users.	Combining the different groups into the same estimation will obscure the treatment effect.
Clustering of types of entrepreneurs	“Lifestyle” entrepreneurs have very different goals from “Innovative” entrepreneurs and therefore will have very different measures of successful performance.	Using the same performance measures for the different types of entrepreneurs will not clearly identify the appropriate treatment effect.
Lack of single performance construct	Different performance measures have been shown to be uncorrelated or negatively correlated with each other.	Without a theoretical foundation for the particular performance measure being used, the validity of the treatment effect is questionable.

III. Research Question

Taking the above discussion into account, the remainder of this paper will focus on answering the following research question:

Do Entrepreneurial Assistance Programs create value for entrepreneurs and if so, how is that value created and how can we evaluate it?

It is important to note that this question focuses the research on determining *how* EAPs create value versus *how much* value is created. In such circumstances Osczan and Eisenhardt (2009)

have suggested that inductive studies (versus the more a traditional deductive hypothesis testing study) are more useful in creating propositions that can answer the research question. Similarly, Pratt (2009) recommends taking a qualitative approach before engaging in quantitative analysis. Furthermore, it appears that the extant literature on EAPs has failed to adequately answer the “how much value is created” question precisely because it has neglected to fully explore the “how is the value created” question through a detailed qualitative analysis. Therefore, a new approach to EAP evaluation is needed that can answer the stated research question by identifying the value assistance creates for entrepreneurs within the context of the established entrepreneurial process literature.

IV. A New Approach to EAP Evaluation: A Qualitative Grounded Theory Case Study

A. Methodology

In order to approach this problem from a qualitative perspective, a grounded theory case study method will be employed. In line with the case study approach detailed by Eisenhardt (1989), an initial research question was defined (i.e. How can we evaluate the impact of Entrepreneurial Assistance Programs?) and used as a starting point to investigate the literature and gather data. The theoretical foundation for this case study will focus primarily on the Shane (2003) model of the entrepreneurial process and the references cited within, as well as more recent research that has built upon this model. The Shane (2003) model provides a basis for understanding all the steps on how entrepreneurs go from discovering an entrepreneurial opportunity to launching a new venture as well as the common obstacles entrepreneurs face along the way. This framework will be developed further below and used as

a context to shape the instrumental case of the Michigan State University Product Center for Agriculture and Natural Resources (or Product Center for short), as an example entrepreneurial assistance program. From analyzing the literature on the entrepreneurial process and problems entrepreneurs face as well as the results from the case study on how the Product Center helps entrepreneurs to overcome those problems, clear propositions will be developed in order to answer the research question on if and how do EAPs create value, and how can we measure that value. In addition, after this process is complete, the Shane (2003) framework itself will be reflected on to see if this case study can provide areas of improvement to the model.

B. Data Sources

The data used for this case study comes from many sources. Initially, in the spring and summer of 2008, semi-informal interviews were held with core staff members and counselors of the Product Center in order to gain a better understanding of its vision, mission and operations. From these interviews and past survey work done by other researchers, a 35-question survey was sent out in fall of 2008 via e-mail and regular mail to all clients who received service from the Product Center in the year of 2007. Of the approximately 500 clients who received the survey, 65 responded. This survey was aimed at better understanding the demographics and satisfaction levels of the Product Center clientele, but also served as the first attempt to collect performance data such as gross annual sales and employment statistics. While the demographic and satisfaction questions were well answered, the performance questions were largely left blank. This difficulty in achieving adequate dependent variables to perform multi-variate regression analysis on, led the author to conduct a series of in-depth interviews with core staff members, counselors and clients. These interviews were conducted

during the fall of 2009. Clients were selected to represent a small cross-section of the various different types of entrepreneurs who typically seek assistance from the Product Center. This included clients who were involved in small, medium and large-scale operations as well as in the food processing, producer, retail and non-traditional industries. No attempt was made to pre-select satisfied versus dissatisfied clients, but there were respondents from both of these categories as well. Counselors were selected based on the recommendation from the assistant director of the Product Center, Tom Kalchik, to include different regions and industry specialties. From this list of thirty potential interviewees, thirteen clients were able to fully participate in addition to five innovation counselors.

These interviews were more formal than the initial interviews with staff members and a structured interview guide was used (see exhibit A, appendix B). The results of these in-depth interviews provided additional hypotheses to be tested and another survey was sent out to 700 Michigan Food Processing entrepreneurs who were both Product Center clients and non-clients in the spring of 2010. Participants were determined by combining a list of Product Center clients in the relevant sectors with a list of all businesses that have applied for a new food license with the Michigan Department of Agriculture in the past five years. A response rate of around 15% (105) was obtained, but not all respondents filled in all the relevant details leaving only 43 usable data points. However, this did not lead to strong quantitative significance for comparison across the client and non-client groups. This lack of significance, however, could perhaps be indicative of the need to evaluate participation in an EAP as more than a simple dummy variable (which is equivalent to comparing across groups). One might expect to find a greater impact from the services an EAP provides within the context of the particular problems

those services help overcome as well as to the extent the client used the services. In any case, this lack of significant quantitative findings is another motivation for conducting a more qualitative case study analysis.

The findings that have come from these data collection endeavors were then analyzed and compared to the extant entrepreneurial process literature presented most prominently by Shane (2003) for convergent validity as well as opportunities for contribution. The findings of this literature review and comparison have then been discussed again with the core staff members in a semi-structured interview (see exhibit B, appendix B) in May of 2011. These interviews and survey results will be discussed in further detail below as the empirical support for the analysis of the case study.

V. Theoretical Foundation

A. Overview of Shane (2003) Framework of the Entrepreneurial Process

Shane and Venkataraman have defined the field of entrepreneurship as “the scholarly examination of how, by whom, and with what effects opportunities to create future goods and services are discovered, evaluated, and exploited,” (Venkataraman, 1997; Shane and Venkataraman, 2000). The general framework of the entrepreneurial process, as established by Shane and Venkataraman (2000), and later refined by Shane (2003) involves (1) the identification and evaluation of opportunity; (2) the decision whether or not to exploit it; (3) the efforts to obtain resources; (4) the development of a strategy for the new venture, (5) the process for organizing those resources into a new combination. These sub-processes ultimately affect the overall performance of the new venture.

Furthermore, each of these different activities are influenced by individual-, industry-, and institutional-level factors that affect the development and execution of the new venture (see figure 2, below).

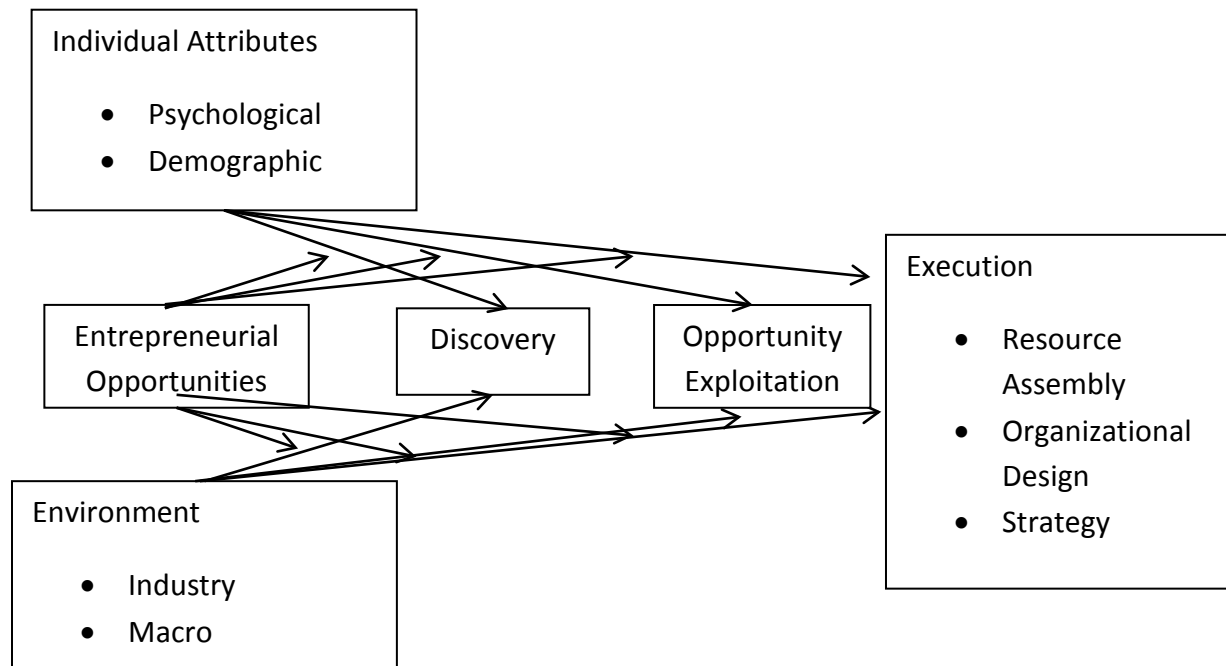


Figure 2: Shane (2003) model of the entrepreneurial process.

Shane's model suggests that entrepreneurial profit can be had if one can discover new ways to utilize the means of production to satisfy current demand or create new demand. These new ways to utilize resources that allows for greater returns than their economic cost is what can be considered an entrepreneurial opportunity (Casson, 1982). The possession of unique information on the part of the entrepreneur allows him to see opportunities where other resource holders or competitors do not. This information is not evenly distributed due to the specialization of information in society (Hayek, 1945), and therefore not all market

participants are in possession of all the relevant information at the same time and only a subset of the population are able to discover a given potential opportunity (Kirzner, 1973).

This leads people to make decisions on the basis of other things besides information alone, such as hunches, intuition, heuristics and even inaccurate information causing their decisions to be incorrect some of the time. These incorrect decisions lead to “errors” of shortages, surpluses or misallocated resources (Shane and Venkataraman, 2000.) Additionally, technological, political, social, regulatory and other types of change are continually adding and updating the potential use of available resources, and hence forcing economies to operate in a constant state of disequilibrium while simultaneously creating the need for new information in market participants’ decision-making processes (Schumpeter, 1934).

Also, the continual change in buyer preferences and needs further exacerbates this disequilibrium by changing the price (demand) people are willing to pay for different products and services. Moreover, due to our imperfect knowledge of the future, the new venture’s future profitability is largely uncertain (Knight 1921). This allows profits to be had through the contracting of the means of production at a certain rate now to be used to create a product sold in a future market at a value that exceeds the appropriate economic rents paid for each factor (Knight, 1921).

These factors then combine to create the possibility of an entrepreneurial opportunity, the discovery of which occurs when an individual perceives he is able to utilize his unique information set to determine that a particular set of resources could be recombined in a novel way to obtain greater returns than those resources’ current underlying economic rents (Shane and Venkataraman, 2000). This opportunity does not have to necessarily turn out to be

profitable, so should not be thought of as a Schumpeterian rent (e.g. Schumpeter, 1934), but does require the creation of a new means-end framework instead of optimizing within a current framework (Shane, 2003).

Individuals who discover an opportunity for a new venture must then evaluate whether or not they wish to become entrepreneurs in order to attempt to exploit that opportunity. To do so, the entrepreneur uses her unique information set, along with certain cognitive characteristics on how she perceives the future expected value of an uncertain venture, to evaluate and determine if she wishes to actually pursue the opportunity. Given the uncertain nature of an opportunity and the asymmetric and incompleteness of information available to market participants, the decision to exploit this opportunity cannot be made through the neo-classical constrained optimization process in response to a given set of alternatives (Baumol, 1993). Instead, citing the work of Kirzner and Schumpeter, Shane and Venkataraman describe this decision in the more familiar economic grounds of an expected utility calculation:

The exploitation of an entrepreneurial opportunity requires the entrepreneur to believe that the expected value of the entrepreneurial profit will be large enough to compensate for the opportunity cost of other alternatives (including the loss of leisure), the lack of liquidity of the investment of time and money, and a premium for bearing uncertainty (Kirzner, 1973; Schumpeter, 1934; from Shane and Venkataraman, 2000).

In essence, in Shane's (2003) model, once an individual feels she has discovered an opportunity to make entrepreneurial profits, she must then use her current information set and risk-preferences to evaluate whether she wishes to commit the time and resources required to attempt to exploit such an opportunity. The perceived expected value of the entrepreneurial profit to the entrepreneur deciding whether or not to exploit it, according to Shane (2003), will

be influenced by three factors: the nature of the opportunity within its external environment, non-psychological characteristics of the entrepreneur such as business experience, education and opportunity cost of the entrepreneur's time and resources, and psychological factors such as risk aversion and cognitive biases. Each has an important impact on this decision, but the role of the external environment as well as the influence of cognitive biases are perhaps most important for this discussion. The role of the external environment can significantly impact the potential for success of a new venture, therefore if an entrepreneur can increase his information set about the external environment he can make more informed decisions that will have a great chance probability of success (for more information on the role of the external environment see Appendix A).

Once the decision has been made to exploit the opportunity, the entrepreneur must execute the opportunity by gathering appropriate resources, developing business strategy and designing an organizational structure. In order to successfully exploit an opportunity, individuals must be able to successfully acquire and utilize the appropriate resources in the actual business operations.

In order to exploit a new venture, there are many types of resources an entrepreneur must acquire. These include physical equipment, land and human capital, but perhaps the most important capital required before launch of the new venture is financial capital. Since the recombination of resources inherent in the exploitation of an entrepreneurial activity must occur before the sale of the output, this exploitation must be financed (Knight, 1921; Shane, 2003). The majority of the time this takes the form of self-financing (Aldrich, 1999). External financing is also available in the form of equity investment which would include funding from

angel investors and venture capitalists, debt-financing, asset-based financing and governmental or non-profit grants.

After acquiring resources for the new venture, the entrepreneur must develop an appropriate strategy to mitigate the technical, market and competitive uncertainty (Shane, 2003). The technical uncertainty that is present comes from the fact the entrepreneur does not know if the final product will be functional nor if it can be produced at a cost less than its ultimate sale price (Amit *et al.*, 1990). The market uncertainty comes from the fact that entrepreneur is uncertain as to whether there will be enough of a demand, in large enough volumes, at a quick enough adoption and a high enough price in order to make the new venture profitable (Amit *et al.*, 1990). While the competitive uncertainty comes from the fact that the entrepreneur is uncertain as to whether she can appropriate the entrepreneurial profits for herself instead of them being dissipated to competition as described above (Amit *et al.*, 1990).

Finally, in Shane's (2003) model, after the decision to exploit the opportunity has been made, resources have been gathered and a strategy is developed an entrepreneur must still engage in the organizing process before the launch of the new venture. This process, occurs over time, and involves such activities as obtaining equipment, establishing production processes, hiring employees and setting up the legal entity for the venture (Katz and Gartner, 1988). The time spent doing this will vary from venture to venture, but on average will take about a year (Reynolds and White, 1997).

In summary, the Shane (2003) model of the entrepreneurial process for new venture formation starts with the existence and discovery of an opportunity, which an entrepreneur

then makes an expected utility calculation on whether or not to exploit. If the decision is made to exploit, an entrepreneur must successfully acquire resources, develop strategy and organize the business in order to launch the new venture. At each stage there are many difficulties an entrepreneur must face and overcome to reach the ultimate outcome of a successful launch.

In the discovery stage, an entrepreneur must somehow acquire information that allows for the entrepreneur to perceive an opportunity that competitors and resources holders do not in order to combine resources in a novel fashion that will provide greater returns to those resources than their underlying economic rents. In the decision to exploit stage, an entrepreneur must be careful not to let cognitive biases impact his or her decision-making in a manner that will lead the entrepreneur to engage resources on what may turn out to be misleading information. In the execution stage, the entrepreneur must overcome the high degree of agency and transaction costs associated with obtaining financing, beneficial supply chain partnerships, and productive employees.

In addition, the entrepreneur must develop a proprietary competitive advantage to protect the venture's ability to appropriate the returns associated with the opportunity's exploitation in the face of competition, supplier power, and new entry of similar products once the value of the opportunity has been signaled to the market. Lastly, the entrepreneur must establish efficient operational procedures and marketing strategies, adhere to industry norms and regulations, and establish a legal entity in order to launch the product (For a summary of the Shane (2003) model see table 2, below).

Table 2: Summary of the Shane (2003) Model

Stage of the Entrepreneurial Process	Shane (2003) Model of what occurs at each stage
Discovery of an Entrepreneurial Opportunity	Alert individuals <i>discover</i> an entrepreneurial opportunity to recombine resources in a novel manner that allows for returns greater than the economic cost of those resources through the recognition of Kirznerian market disequilibrium or a Schumpeterian opportunity that will create such disequilibrium.
Decision to Exploit the Opportunity	Entrepreneurs engage in an expected utility calculation comparing their perception of the expected value of the entrepreneurial opportunity to their current status quo and decide to exploit when their perception of expected utility of the opportunity is greater than the status quo.
Execution of the Opportunity	Entrepreneurs must overcome the uncertainty and information asymmetry inherent in acquiring resources, develop strategies to sustain a proprietary competitive advantage and create and institute proper organization methods in order to successfully exploit the entrepreneurial opportunity and launch their new venture.
Performance of the New Venture	To the degree that the entrepreneur has successfully recombined resources that can be sold at a price greater than their associated economic cost, can withstand the pressures of competition the venture will succeed until resource holders increase their rates to appropriate the increased profits for themselves or changes in technology, consumer demand or political regulation cause enough disruption to make the venture unviable.

Given this framework for the entrepreneurial process, the instrumental case of the MSU Product Center will now be developed in order to shed light on how an EAP can create value by assisting entrepreneurs overcome these difficulties at each stage.

VI. Case Study Details

A. Overview of the Michigan State University Product Center

The Michigan State University Product Center for Agriculture and Natural Resources (or The Product Center for short) was created by a memorandum of understanding among the MSU College of Agriculture and Natural Resources (CANR), Michigan State University Extension (MSUE), and the Michigan Agricultural Experiment Station (MAES) on March 1, 2003 and is still in operation as of today (2011). The original mission was, “To be a catalyst for the creation of profitable futures for businesses and industries engaged in Michigan’s agriculture, food and natural resources systems.” This was then expanded into a three part framework that emphasized the Product Center’s role as a business and technical assistance program, a market research institution and an entrepreneurial education provider (from MSU Product Center Strategic Plan, 2007).

However, over time, it became clear that the entrepreneurial education component was not highly valued by the entrepreneurs themselves, and this component was dropped in order to focus more heavily on the other two.

The Product Center’s team consists of a core group of self-directed staff members involved in all or most of the organization’s processes, a small executive group comprised of the Product Center director and the two associate directors, who take actions and make commitments on behalf of the organization, and two operating subgroups: a research subgroup—composed of university faculty and students who engage in interdisciplinary research aimed at identifying and supporting actual and potential clients’ needs; and a venture development subgroup—who

work with the actual and potential business clients, as well as the internal and external partners, to provide the analysis and services the clients require. In addition, the Product Center has a vast network of affiliates who support the organization in its operations and an information cadre of persons, including previous clients, partners and stakeholders, who have a strong interest in the operations but are not currently actively involved.

The Product Center's central offices are housed on the campus of Michigan State University, but its innovation counselor network is dispersed throughout the entire state of Michigan, operating through MSU's extension network. This structure allows clients to have their first contact with an innovation counselor in their local extension offices, with more advanced services offered on campus.

B. Overview of the MSU Product Center and its Process for Assisting Entrepreneurs

The Product Center operates on two levels: an innovation counselor network that operates through MSU's extension network throughout the state of Michigan and an on-campus specialized service unit (see figure 3, below). At the extension level, selected extension agents

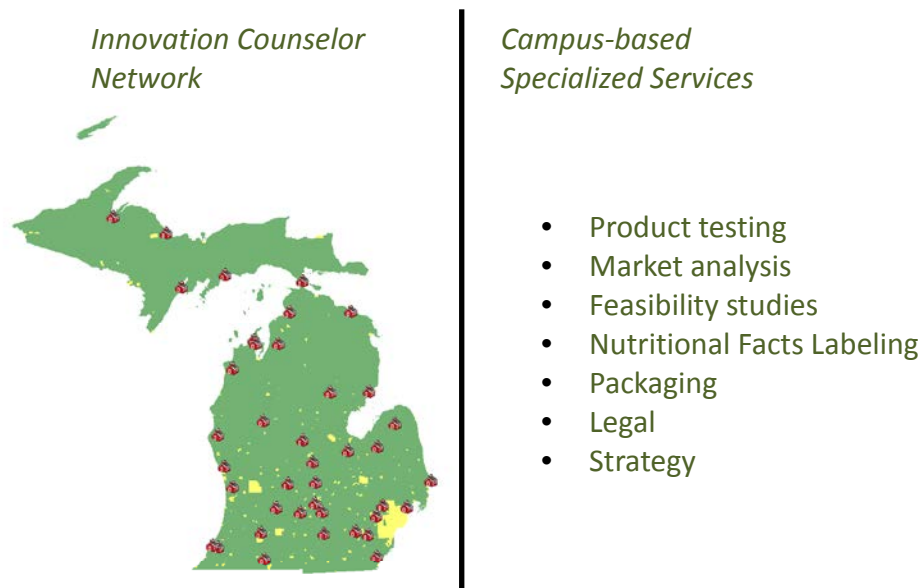


Figure 3: Divisions of the Product Center

For interpretation of the references to color in this and all other figures, the reader is referred to the electronic version of this thesis

are trained to be “Innovation Counselors” who serve as a first contact for individuals interested in receiving services from the Product Center. The on-campus specialized service unit assists entrepreneurs by either directly providing services to clients or connecting them to on-campus departments. The services provided are: packaging, nutritional labeling, assistance in obtaining

financing, feasibility studies, food-safety testing, assistance in supply-chain entry, product testing, strategic advice and legal assistance.

The basic process which the Product Center follows is as follows: Innovation Counselors will first engage in counseling sessions with clients to determine feasibility of their business idea and its implementation and begin the Product Center process (see figure 4, below).



Figure 4: Overview of the Product Center Process for Assisting Entrepreneurs

From this session, the counselor will use his or her own knowledge and training to help clients develop their idea into a more defined venture concept. After the venture concept is

developed, the Product Center will classify the new venture to be in the “start-up” phase prior to launch and counselors either help the clients directly or refer them to the on-campus specialized service unit to assist with business planning. This business planning will involve detailing the entrepreneur’s strategic and operational goals and plans for achieving them, as well as assistance in creating a formal business plan and testing its market feasibility. As the venture concept is further developed counselors may also refer clients to the on-campus specialized service unit or to the network of partners the Product Center has developed in order to assist in filling resource-gaps that an entrepreneur may have in developing their product for launch. Finally, once the a sound business plan is in place and the product has been sufficiently developed, the Product Center assists entrepreneurs in the launch of their new venture through finding and identifying scale-appropriate opportunities to pursue. The details of how each stage of the process assists entrepreneurs will be developed in greater detail further below in the case study.

C. Summary of Counseling and Technical Services Provided

Since it began operations in 2004 the Product Center’s staff has had over 15,805 one-on-one client sessions, helped 1,434 clients with developing their venture concept, has gotten 881 clients to the start-up stage and helped to produce 164 launches. In addition the Product Center has also provided over 917 clients with different specialized service assistance (see table 3 below).

Table 3: Summary of the services provided by the MSU Product Center

SERVICES PROVIDED		SINCE 2004	In 2010
One-on-one client counseling sessions		<i>15,805 sessions</i>	<i>3,672 sessions</i>
Assistance with business concept development		<i>1,434 clients</i>	<i>318 clients</i>
Venture start-ups		<i>881 clients</i>	<i>160 clients</i>
Specialized services		<i>917 clients</i>	<i>204 clients</i>
Venture launches		<i>164 ventures</i>	<i>19 ventures</i>

D. Example of Client Experience

The best way to understand how the Product Center works, however, is to see it through the eyes of its clients. Take for example, one food processor who came to the Product Center for assistance in launching her line of vegetarian and vegan packaged food mixes and spices. This food processor first had the idea for her line of products when noticing the lack of smaller sized vegetarian ingredient mixes at her local food co-op. Instead, customers like her would have to buy things in bulk and expend a lot of time and energy bagging and storing everything. She also wanted to create something healthy that people would like to eat and so began to work with private labelers to bottle some of her seasoning recipes. As she was searching the internet for information about nutritional analysis, she found something that mentioned the Product Center and decided to contact them.

In total, she met with Product Center counselors about five times to talk about nutritional analysis, packaging, labeling as well as marketing and distribution. She described the counselors as being, “Good mentors to bring things by and to talk about ideas. (The Product Center) has helped (her and her business partner) with a lot of support about different marketing ideas and distributors.” She described how one of the core staff members in specialized services was, “very helpful by displaying (their) products and talking to other people” in setting up different marketing and distribution opportunities. She also worked on creating a business plan with the Product Center but felt a bit overwhelmed with the number crunching and was not interested in obtaining a loan and ineligible for most grants. Ultimately, she didn’t finish one because she didn’t feel that it was needed. Despite the lack of a business plan, she worked on the idea for a year and a half before launching the product.

Upon reflection, she described the mentoring advice she received as the greatest benefit from the Product Center. In her words, “The counselors have been very great to work with. The mentoring, sounding board, advice and suggestions have all been extremely helpful.” Another client echoed this sentiment by commenting on how the Product Center, “Helped her to know whether she was on the right track or not, and whether to know if what they were proposing was feasible, a real ‘reality check’.” This story exemplifies many clients’ experience who come to the Product Center with an idea for a food business, but are unsure the proper way to move forward to actually launch the venture. This client’s experience also exemplifies how many entrepreneurs will use some but not all of the services provided by the EAP, nor do they always follow a linear path through the framework that the PC has established for venture creation.

VII. **Theory: Impact of Cognitive Biases**

The cognitive characteristics of an entrepreneur are also critically important, according to Shane (2003) in making the decision on whether to exploit a perceived entrepreneurial opportunity. Given that less than 50% of new businesses survive for more than five years (Cooper, Woo and Dunkelberg, 1988), it was first hypothesized that entrepreneurs must have a high propensity for risk or place a higher utility on the use of new ventures to satisfy their need for achievement (McClelland, 1964) over the profit capabilities of the venture. However, further research has found little evidence for an “entrepreneurial profile” that such hypotheses would suggest is inherent in those willing to take such long odds.

Some more recent studies have found that entrepreneurs simply perceive less risk as being involved (Simon, Houghton, and Aquino, 2000) or are more subject to cognitive biases that cause an individual to overestimate the expected utility of a new venture (Baron, 2004).

Individuals facing uncertainty have certain heuristics and biases that also influence their decision-making processes (Busenitz & Barney, 1997). More importantly, these heuristics and biases vary across individuals and will have a significant impact on who decides to become an entrepreneur and the probability of success of the venture (Venkatraman, 1997). This variation is useful in determining not only why some individuals become entrepreneurs when others don't, but also in evaluating why some ventures fail and others do not. Specifically, though certain biases and heuristics will increase the likelihood of deciding to exploit a perceived entrepreneurial opportunity, it can also negatively impact the probability of success of that entrepreneurial opportunity if the entrepreneur does not fully appreciate the costs or risks involved and take appropriate measures to deal with them.

One well documented bias entrepreneurs often have is known as Prospect Theory. This bias centers around the different weights individuals place on gains versus losses. In particular, prospect theory hypothesizes that the slope of the subjective utility function an individual places on losses is steeper than the slope placed on gains (Baron 2004). For example, imagine a situation where one had the opportunity to choose from taking a \$500 check, no questions asked, versus playing a game of double or nothing with the \$500 based on a coin flip. Prospect theory would predict that most individuals would choose to have the sure thing. However, if the game were reversed, and one had the choice between paying \$500 or having an opportunity to double or nothing the debt, many more individuals would opt to take the gamble. In both situations, the expected value of the gamble is the same (i.e. \$500). The subjective value an individual places on the benefit of the gamble, however, is quite different. Namely, in the first situation one has the opportunity to gain an additional \$500, which is valued less than the second situation where one has the opportunity to reduce one's loss by \$500.

In terms of entrepreneurs, to the extent that they view not acting on a potential entrepreneurial opportunity as a loss of potential revenue that could be had if exploited, versus looking at the opportunity as a source of potential returns for one's current set of resources, then they will be more likely to place a higher subjective utility on the decision to exploit that opportunity (Baron, 2004). Prospect theory also suggests that people overweight small probabilities, such as with the millions of state lottery players who are willing to pay \$1 for a ticket whose expected value is often quite less than the dollar they are paying (Baron, 2004). So though most new ventures fail (Cooper, Woo and Dunkelburg, 1988), many entrepreneurs will

cite examples from notable exceptions such as Google, Facebook or more recently Groupon as a justifiable counterpoint to why they can disregard such statistics.

Other errors of thinking, or cognitive biases, pointed to by Baron (2004) include such things as the optimistic bias – which is an overweighting of positive outcomes (Shepperd et al, 1996), the confirmation bias – which is the tendency to only pay closer attention to information that confirms our current beliefs (Kolchinski, 2001), the planning fallacy – a belief that we can get more done in an allocated time interval than is actually possible (Buehler et al, 1994), the illusion of control – the tendency to believe one’s own skill can influence outcomes even when random chance plays a significant role (Simon et al, 2000) and the law of small numbers – using a small sample size to draw general conclusions (Simon et al, 200). All of these biases have the potential to increase the perceived expected utility of an entrepreneurial opportunity to an individual considering whether to exploit it.

In fact, it may be that due to the low odds of successfully discovering and exploiting an entrepreneurial opportunity, a certain amount of cognitive bias is necessary to prevent the entrepreneur from either never attempting to launch the venture or giving up too early during the initial development stages that are likely to have low or negative returns (Baron, 2004; Simon et al, 2000). This might explain why some have found these biases to be quite common among entrepreneurs (Busenitz and Barney, 1997).

However, some have suggested that, though a certain amount of cognitive bias is helpful, successful entrepreneurs are better able than the unsuccessful ones to provide a counterbalance to these biases in order to hold them in check (Baron, 2004; Simon et al., 2000). The more that the entrepreneur can build and engage “safety nets” that provide checks on

whether a cognitive bias is leading them down a potentially negative path, the more successful they will be at exploiting an entrepreneurial opportunity (Simon et al, 2000). This is because, though these biases help individuals when making complex and uncertain decisions (Schwenk, 1984), they may result in those entrepreneurs making decisions that are not well thought or appropriate to the problem at hand (Barnes, 1984).

In addition, the more an entrepreneur can think counterfactually and systematically and avoid other biases, such as the attachment to sunk costs, the better decisions they are likely to make and hence increase the probability of success for the new venture (See Appendix A for Baron's comparing why some individuals but not others become entrepreneurs vs. why some entrepreneurs but not others succeed).

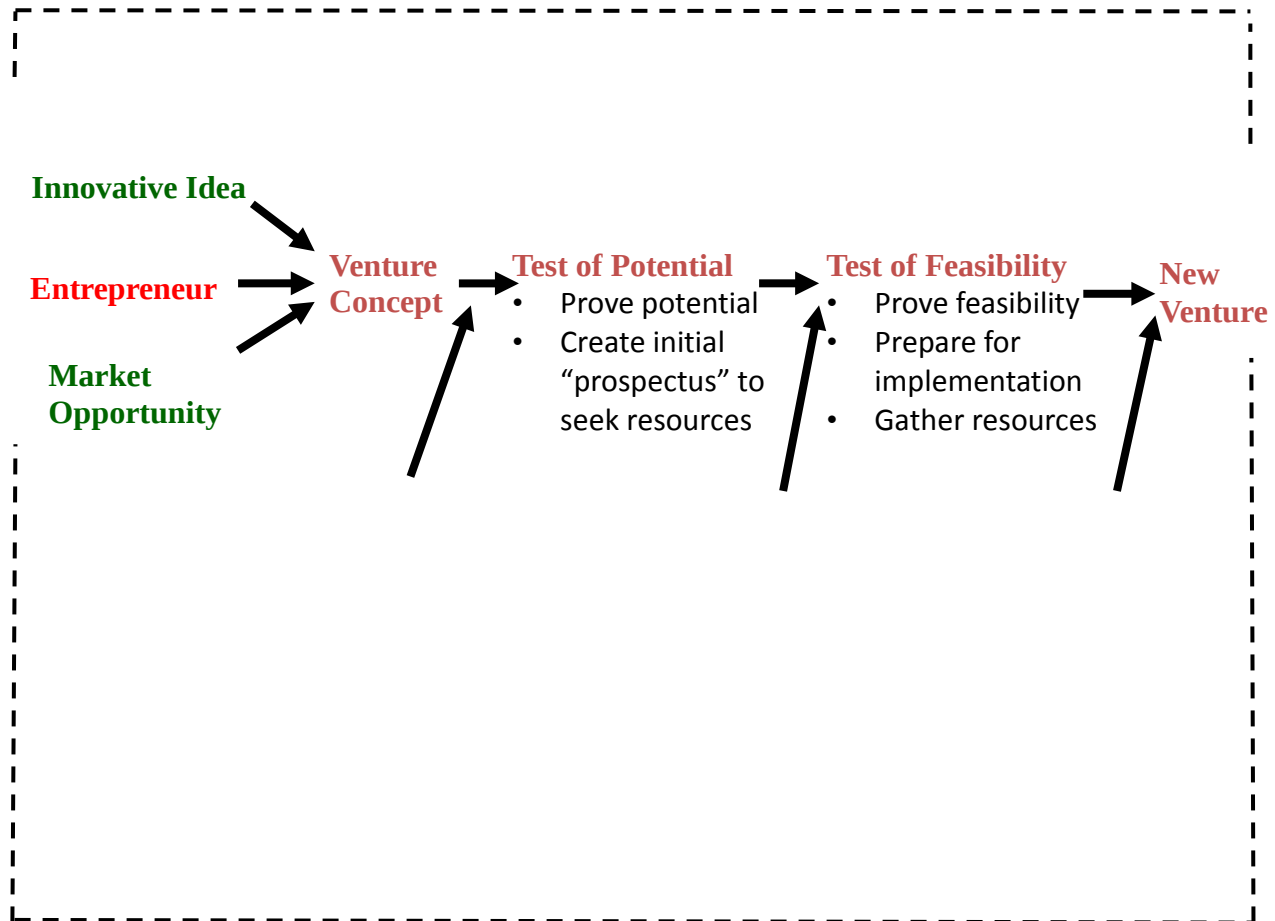
VIII. Case Study: How the Product Center helps to overcome problems associated with Cognitive biases

When an entrepreneur has an idea, but has not yet developed the business behind it, the Product Center counselors will help the client through venture concept definition development. According to the associate director of the Product Center, Tom Kalchik, "In the concept definition stage, we ask a series of questions such as, "Who is your customer?, Why would they buy your product?, Who are your competitors?, What do you want to do when they enter the market?, How much do you want to make?, How much time do you want to commit to the venture? And so on." (For a complete list of the questions asked in the concept definition see exhibit D, Appendix B).

As suggested by Mr. Kalchik, this concept definition process helps the entrepreneur to more fully appreciate what is needed to create a functioning business and the amount of work involved in turning their idea into a formal launch of a product. Counselors will encourage those who have not thought about these details or whose ideas might have gaps in the concept definition, to work on the concept development some more and return to the Product Center once this work is completed. It has been the experience of many of the counselors that entrepreneurs in this stage of the entrepreneurial process often have not fully thought about all the strategic and operational aspects of how to successfully turn their idea into a new venture. According to the supply chain specialized service coordinator Matt Birbeck, “Entrepreneurs, especially food entrepreneurs, believe that the product is the driver of their success. It’s not. The business, opportunity and the gap in the market should be the driver. So this concept development is really about discovering the gap.”

In its framework for new venture creation (see figure 5, below), the Product Center posits that in order for a venture concept to be defined, there must be an innovative idea, a market opportunity (or gap) for that idea and an entrepreneur willing to bring the idea to fruition. If any of these three components is missing, then the idea cannot be considered a well-defined venture concept (see Appendix B for complete set of questions that define the Venture Concept).

A FRAMEWORK FOR NEW VENTURE CREATION



As opposed to the Shane (2003) framework which posits that entrepreneurs discover opportunities, or gaps, in the market that they then decide to try to exploit, the Product Center's experience has been that, "none are coming in to fill the gap in the market," according to Mr. Birbeck, "100% have an idea or they wouldn't be there. The drivers are that 50% say they want to bring (the idea) to fruition (regardless of any explicit market opportunity), while the

other 50% say someone has told them something that makes them believe there is an opportunity (for the idea) in the market.”

Once the idea is developed into a formal venture concept, the Product Center assists entrepreneurs to first test the potential of the concept using general market information to provide external validity to the strategies entrepreneurs develop as they begin to first put in the “sweat” equity required for their venture. If there appears to be enough potential for the venture, then the Product Center will provide entrepreneurs with more in-depth and specific feasibility information, as well as strategic and operational business planning advice, to test the feasibility of the venture. This may or may not result in a formal business plan, but in either case will provide the basis for entrepreneurs to seek out the resources and trading partners they need to launch their venture.

The lack of business acumen and susceptibility to cognitive biases such as relying on the law of small numbers and confirmation bias¹, can lead many entrepreneurs to try to launch products without clear market opportunities and ultimately suffer hardships or failure (Shane, 2003; Baron, 2004). The Product Center indicates that it tries to help entrepreneurs avoid these hardships, however, through using market research, a counselor’s tacit knowledge and information gathered from its network of suppliers, lenders, distributors, retailers and

¹ Relying on a small sample of friends’ advice, instead of using broader market analysis, is an example of the cognitive bias known as the law of small numbers. If the entrepreneur further hears only what she wants to hear from her friends, such as how great the product tastes and it’s sure to sell, would be an example of another typical cognitive bias known as confirmation bias.

institutional food consumers (such as local hospitals) to help provide external validation of the market opportunity for an entrepreneur's innovative idea.

This can be done, as associate director Tom Kalchik puts it, in the test of potential and test of feasibility stages by using “resources like Mintel® to help them identify what the market is, and tie that into MarketMaker® (an online service that connects buyers and sellers) so they can identify areas where people who might buy their product are located and set up distribution systems. We'll use the global new product database (GNPD) to see who the competitors that are out there are.” Once this is done, Mr. Kalchik explains that the entrepreneur will have a much clearer picture of if a feasible market opportunity exists for their innovative idea, and what steps they must start to take to try and exploit that opportunity.

Counselors will also assist entrepreneurs determine if they truly wish to pursue their business idea by helping the entrepreneurs more fully appreciate the time, effort and risk involved in turning the idea into the launch of a new venture. As one innovation counselor put it, “Some (entrepreneurs) are not ready to give up other important commitments in order to support the business. This is the case with a lot of people that come to the Product Center. There's a quiz given in “tilling the soil of opportunity” that asks questions about are you willing to work weekends, evenings, give up vacation/family time. So the business might work, but on a personal level the costs outweigh the benefits.”

During this process, many clients will decide not to return either because they have become discouraged if no explicit market opportunity was identified or did not appreciate the work involved. This discouragement of less tenable ideas or individuals not willing to put forth the

effort is what lays behind the concern about selection bias mentioned in the Entrepreneurial Assistance Program literature above.

Also, if the idea is untenable, and likely to fail, then the Product Center clearly provides value to both the entrepreneur and society by preventing resources from being wasted in a failed venture. The benefit to the entrepreneur is the obvious prevention of loss of wealth, whereas society theoretically will benefit from those same resources being put to better use somewhere else. Furthermore, it should also be noted that simply because an entrepreneur does persist in the Product Center process, this does not mean they have not been discouraged from pursuing untenable strategies. The venture concept development can be an iterative process of rejecting many less tenable venture concepts and strategies before a more tenable strategy can be created that has a perceived market opportunity for the entrepreneur to move forward on. In this way, the Product Center is not only “weeding out” bad ideas, but “planting in” good ones.

According to the Product Center’s staff and counselors, providing counseling and external validity to entrepreneur’s venture concept and strategy is a key component of what the Product Center does. According to one counselor, “The (market) is brutal and not fun, there’s a lot of carnage, a lot of losers. The Product Center brings a certain dose of reality to a lot of people who have an unclear idea of what it takes to make a business. The Product Center can help tweak what works, show what doesn’t and use market research to show if the idea is new to the world or can benefit from the experience of similar products or services.”

Core staff member, Matt Birbeck, describes how one of the most important roles of the Innovation Counselors is to help clients to see beyond their passion for their product and begin to understand the fundamental business principles needed to make the venture successful. According to Mr. Birbeck, “Entrepreneurs believe that they have the best thing that is ever made. But then I tell the entrepreneurs you have to have the business to sell the product, totally removed from the passion behind the product. (I ask them) what’s your competitive advantage? I don’t want to hear any more words about how it’s the best tomato sauce flavor or whatever, now you have to create a business that sells the product. That’s when most entrepreneurs stumble. They have no expertise in (how to create the business).”

This may be one of the most important stages where an Entrepreneurial Assistance Program can provide benefits to would-be entrepreneurs. As was remarked above, Product Center clients often ascribe the ability of the counselor to provide a “reality check” or “sounding board” for their ideas as one of the most beneficial services they had received. In regards to the entrepreneur’s decision to exploit, by leveraging the counselor’s tacit strategic knowledge into the entrepreneur’s information set in developing the entrepreneur’s concept definition they can thereby make better decisions as to whether or not to exploit a particular opportunity. This will lead to the “weeding out” of bad ideas, which is beneficial in light of the opportunity cost of wasting resources on untenable ideas, as well as the “planting in” of good ideas that otherwise may not have been exploited due to a lack of knowledge on the entrepreneur’s part on how to properly execute the idea without the assistance of the Product Center. In this way, the counselors’ can provide a check on whatever cognitive biases an entrepreneur may have in order to help them make better decisions.

This “weeding out” and “planting in” process, however, relies heavily on the ability of counselors to correctly determine if a clients’ venture concept and strategy can be used to exploit market opportunities that the counselor can identify. Therefore, depending on the skill of the counselor and whether or not the entrepreneur has need of this skill, the benefit provided will vary accordingly. This would suggest that those with more relevant business or industry experience would likely find this counseling less useful. In addition, unskilled counselors may not be able to assist as well as ones with more experience and training. These complicating factors will act to confound comparisons of performance data if not appropriately addressed, and is an area that needs further development for proper evaluation of the EAP impact. Nonetheless, the value of focusing entrepreneurs on developing a formal venture concept definition early on is clearly a benefit provided by the Product Center. This leads to first set of propositions to come out of this case study:

Proposition 1

Entrepreneurial Assistance Programs can create value for entrepreneurs by increasing the probability of success and survival of their clients’ new ventures by helping to provide a check on the negative impact of cognitive biases in strategic decision-making by counseling clients to systematically identify and validate their market opportunity and venture strategy.

A. Benefits of Counseling

Shane (2003) model of the decision to exploit provides convergent validity for these propositions. In examining the process by which Innovation Counselors can help entrepreneurs decide whether or not to exploit a perceived entrepreneurial opportunity, it is clear that they must take into account the external environment, personal characteristics and common

cognitive biases that their clients might have. Evaluating the external environment with entrepreneurs can help them better understand the potential for an opportunity, the likely competition, the regulations and the social norms and standards for the new venture. Examining an entrepreneur's personal characteristics such as business experience, personal resources and goals for the venture, can allow the EAP to better target what services it can provide to help fill any gaps the entrepreneur might have. Finally, the formal process of developing the venture's strategic and operational plans early on in the process can help entrepreneurs to overcome the common cognitive biases that can influence the decision to exploit an opportunity.

This is useful because determining expected value for new ventures is likely to have a high degree of error. By definition, given that the new venture will be a new combination of resources, there is no historical data to go on. This brings a lot of risk and uncertainty to the expectation. This also allows one's idiosyncratic perceptions and cognitive biases to have a strong influence. However, if a systematic process of evaluating the venture's strategy and comparing it to similar ventures' experience is used, a much more realistic expectation can be ascertained. This more realistic expectation will then have a higher probability of discouraging bad venture strategies from going forward early on the process and encourage good strategies to be more completely developed. This process coincides with Baron's (2004) description of why some entrepreneurs succeed and others don't. Namely, when focusing on strategy in a systematic way and counterfactually evaluating the venture concept, the entrepreneur will therefore be more likely to have success in their new venture.

Furthermore, the Product Center's model's implication that opportunities are created as well as discovered rather than Shane's (2003) model that explicitly models opportunities as external to the entrepreneur, further supports the value of developing strategy before the decision to exploit is made. Posing the opportunity as external to the entrepreneur, as in the Shane model, implies a certain "static"-ness to the expected utility of the new venture. In this case, the decision depends solely on the value of the external opportunity and strategy only becomes useful in how to best exploit the opportunity.

If the opportunity is a created idea that can be more dynamic, however, then the skill of the strategy employed should directly impact the expected value of the new venture. This would imply that strategic decisions could directly impact the venture's expected utility. Therefore if one makes the decision to exploit before strategy is considered, one will not be able to appropriately gauge the true value of the opportunity. This, in turn, will cause an entrepreneur to rely more on cognitive hunches (highly subject to bias) and potentially make poor decisions about whether or not to exploit an opportunity.

IX. Theory: The Problem of the Liability of Newness

There are two basic characteristics of new ventures that make acquiring resources and developing ties to trading partners difficult for entrepreneurs – uncertainty and information asymmetry (Shane, 2003). Entrepreneurial opportunities are, by definition, uncertain because the profitability associated with the new resource combination is unknown before the launch of the venture (Arrow, 1974). In addition, in an environment that does not fully understand or

acknowledge their existence it can be quite difficult for new organizations to establish ties with the trading partners they need to organize their venture properly (Hannan & Carroll, 1992; Stinchcombe, 1965). These characteristics create what Stinchcombe (1965) has termed “the liability of newness” that is often a key contributor to the low survival rate of new organizations.

Overcoming the issues associated with uncertainty and information asymmetry is important because the obtainment of capital has been shown to make new venture more likely to survive and become profitable through having a buffer against adverse situations (e.g. Carroll and Hannan, 2000; Ranger-Moore, 1997; Banaszak-Holl, 1991) and removing liquidity constraints on the possible actions the venture might take (Shane, 2003). Entrepreneurs often have a lot of difficulty in obtaining the appropriate resources for their venture due to their small size, inexperience, lack of a track record, entrepreneurial opportunity uncertainty and asymmetric information problems (Shane, 2003).

A. Resource Acquisition Problems

In order to exploit a new venture, there are many types of resources an entrepreneur must acquire. These include physical equipment, land and human capital, but perhaps the most important capital required before launch of the new venture is financial capital. Since the recombination of resources inherent in the exploitation of an entrepreneurial activity must occur before the sale of the output, this exploitation must be financed (Knight, 1921; Shane, 2003). The majority of the time this takes the form of self-financing (Aldrich, 1999). External financing is also available in the form of equity investment which would include funding from

angel investors and venture capitalists, debt-financing, asset-based financing and governmental or non-profit grants.

For entrepreneurs without observable track records or products, resource providers must make financing decisions on very little information and their own intuition (Bhide, 2000). Due to this limited information and evidence, investors face high risk in financing entrepreneurial opportunities (Low and Srivatsan, 1994), which can result in high interest rates on loans to cover this risk or the inability to get a loan at all.

The uncertainty of the new venture's profit stream also creates difficulties in determining the net present value of the venture, which can lead to differences of opinion about the venture's value between the entrepreneur and the lender (Wu, 1989). This can create bargaining problems, and result in the resource provider offering less than what the entrepreneur believes is the value of the opportunity (Shane, 2003). Furthermore, resource providers might wish to have collateral (Blanchflower and Oswald, 1998) against default if the entrepreneur fails and cannot pay back the loan (Casson, 1982). This will pose significant problems for those entrepreneurs without suitable collateral to offer.

Information asymmetry, defined in this case where the entrepreneur holds more information about the value of the opportunity and her own dedication and work ethic in regards to exploiting it, creates four major obstacles(see figure 6, below) to capital acquisition (Shane, 2003).

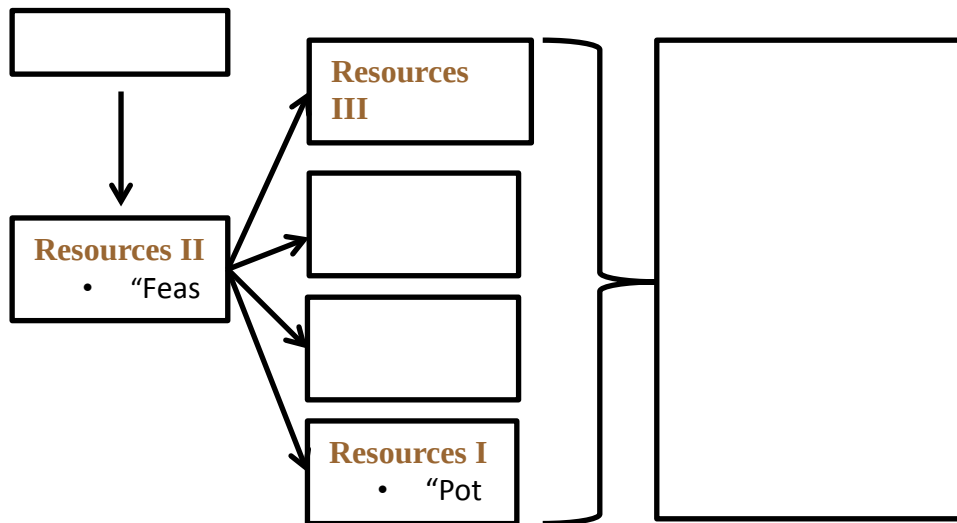


Figure 6: Consequences of Information Asymmetry and Uncertainty

The first comes from the natural tendency of entrepreneurs to want to keep key information about the value of and the method for exploiting an opportunity. Making this information known could cause others to attempt to exploit it as well, thus bidding up the requisite resource prices associated with that opportunity (Casson, 1982) or may cause the resource providers to exploit it themselves. This secrecy leads to resource providers to make decisions with incomplete information, and may cause them to refuse to finance the venture or not provide enough financing as is needed (Shane, 2003).

Second, this information asymmetry also allows for opportunism on the part of the entrepreneur through obtaining more resources than their venture requires (Shane and Cable, 2002) or by getting better concessions on the investments or loans than a resource provider with a full information set would allow (Shane, 2003).

Third, there is also some moral hazard risk in the entrepreneur engaging in unnecessarily risky behavior once he has received the loan, or not putting forth an appropriate effort level as is required to fully exploit the opportunity. This, in turn, will make resource

providers take safeguards against opportunism and increase the transaction costs involved in obtaining financing (Williamson, 1975; 1985; 1986). These safeguards often involve resource providers offering fixed rate financing at high interest rates so the entrepreneur bears the risk. At high rates, however, entrepreneurs will be more likely to favor risky projects with high potential returns (Barzel, 1987) as low to moderately risky projects with low to moderate returns will be less likely to be profitable, given the high interest rates.

Lastly, given there is a range of ability in both discovering and exploiting entrepreneurial opportunities, those who are less skilled at doing so will seek financing in addition to those that are more skilled. If the resource provider cannot distinguish between the varying skill levels, then this can create a “market for lemons” (Akerlof, 1970) and lead to adverse selection in the lending market (Amit et al, 1990). This will have the net effect of lenders either refusing to participate in the lending market, or participating only by offering interest rates appropriate for less skilled individuals. Since they are less skilled, and therefore more likely to default, these rates will be significantly higher than would be appropriate for those who are more likely to succeed in their new venture, potentially to the point of being cost-prohibitive.

B. Difficulty in establishing trading partnerships

In much the same way that the “liability of newness” as described above makes it difficult for entrepreneur to acquire resources, it also makes it difficult to establish trading partnerships downstream in the supply chain. In particular, if a venture is perceived as lacking legitimacy, defined by Suchman (1995) as “a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed

system of norms, values, beliefs, and definitions" then it will be less likely for trading partners such as distributors, processors and retailers to invest time and resources in the new venture. This is because cooperation from such partners is often based on trust, reliability and reputation, which in turn are based on familiarity and evidence (Bateson, 1988). In situations where entrepreneurs have little evidence that their new venture will work out well, and the trading partners do not already have an established trust relationship, there is little reason for them to engage in the relationship (Aldrich and Fiol, 1994). Therefore, as Zimmerman and Zeitz (2002) have described, a new venture must engage in activities that foster legitimacy (especially those that cost little or no money due to the scarcity of resources most new venture have) in order to cross a certain legitimacy threshold. If the new venture can cross this threshold and be "judged legitimate it can receive access to the capital and other resources it needs (e.g., Andrews, 1996; Deeds, Mang, & Frandsen, 1997) ... below which the new venture will probably perish," (Zimmerman and Zeitz, 2002).

C. The Competitive Uncertainty Problem

After acquiring resources for the new venture and establishing ties to trading partners, there are still three types of uncertainty involved in the execution process, according to Shane (2003), which the entrepreneur must develop an appropriate strategy to mitigate. These are: technical, market and competitive uncertainty. The technical uncertainty that is present comes from the fact the entrepreneur does not know if the final product will be functional nor if it can be produced at a cost less than its ultimate sale price (Amit *et al.*, 1990).

The market uncertainty comes from the fact that entrepreneur is uncertain as to whether there will be enough of a demand, in large enough volumes, at a quick enough adoption and a high enough price in order to make the new venture profitable (Amit *et al.*, 1990). While the competitive uncertainty comes from the fact that the entrepreneur is uncertain as to whether she can appropriate the entrepreneurial profits for herself instead of them being dissipated to competition as described above (Amit *et al.*, 1990).

A successful exploitation of an entrepreneurial opportunity will ultimately result in the new venture earning profits above the economic rents associated with the factors of production (Knight, 1921; Schumpeter, 1934). However, the returns to the exploitation will dissipate to competitors and resource holders unless the entrepreneur is able to develop a proprietary competitive advantage (Shane, 2003). A proprietary competitive advantage consists of some mechanism that prevents competitors from imitating and exploiting for themselves the opportunity the entrepreneur has identified and developed into a new venture.

Shane (2003) explains that the returns are expected to dissipate for three reasons: (1) The factors that created the initial opportunity will be replaced by different social, technical and regulatory change that will generate new opportunities in place of the old ones (Schumpeter, 1934); (2) Once the opportunity is successfully exploited resource holders will raise their prices to extract some of the entrepreneurial profits for themselves (Kirzner, 1997); and (3) most importantly, opportunities are exhausted by competition (Shane, 2003).

While the whole entrepreneurial process is aimed at exploiting an opportunity that others have not seen, by the very act of a successful exploitation, the entrepreneur signals to

the rest of the market how to identify and exploit that opportunity (Campbell, 1992). This signal of profit acts “like blood in the water for sharks giving incentive to competitors to bid for the resources necessary to exploit the opportunity” (Casson, 1982, Shane 2003). This bidding will cause the underlying resource prices to rise until the profitability of the opportunity is exhausted (Schumpeter, 1934; Shane and Venkataraman, 2000).

X. Case Study: How the Product Center helps to mitigate the problems associated with the liability of newness

A. Assistance in developing a proprietary competitive advantage

After the venture concept has been developed, the Product Center defines entrepreneurs to be in the “start-up” phase. This is the phase that occurs before launch, but involves more formal business planning, product development, the gathering of resources and the actual organization of the business. In the beginning of this process, the Product Center recommends entrepreneurs to focus more in-depth on business planning and the development of business strategy. This may or may not involve the creation of an actual business plan, but in either case will involve having the entrepreneur begin to formally map out their strategic plan for the new venture. This is because when entrepreneurs come to the Product Center, whether in the venture concept development stage or the start-up stage, they often have not thought deeply about what their business strategy is going to be.

Instead, as was discussed above, they’ve focused on their passion – the development of their product; and feel that the product itself will be the sole determinant of success. As Mr. Birbeck puts it, “(Entrepreneurs) think their biggest advantage they have is this secret way of

how their jam or jelly is made. I turn around and say to them, that's really the least important of things that you have. What you have is an asset and now you have to build the business to sell the product."

In the case of the food processors the Product Center has worked with, building the business to sell the product is often primarily concerned with building the product's brand equity. To do this, according to specialized services consultant Dianne Novak, entrepreneurs must consider many things including, "the uniqueness of the product, how it differentiates itself from similar products, the look and marketing of the product and the quality of ingredients, (so that when) people buy your (product) they'll buy it again and be your following."

This is something the Product Center clients often overlook or feel they don't need to be concerned about at this stage. According to Mr. Kalchik, "Many times (entrepreneurs) think the label is the brand," and will have left it at that without the assistance of the Product Center. In addition, according to Mr. Birbeck, "(Entrepreneurs) will look at you and say why do I have to build a brand? I'm not a national company, and they think that just because it tastes good (they) don't have to build a brand."

Instead, entrepreneurs will often design a label and try to gain entry into a large retail store such as Meijer. This can be quite detrimental to a small start-up food processor as without sufficient brand equity, one will not be able to achieve the sales volume needed to stay in such large retail stores. As Mr. Birbeck puts it:

To build the brand you throw a stone in the water and build the ripples. So you take it to one store and get some success and go from there to another one. It's not that Meijer is a bad place to go, but Meijer will always say yes, and take you into their store and if you don't achieve enough sales volume will kick you out. You have to build your customer loyalty. That happens at a farmer's market and local store level that builds that reputation and sales volume. And when you have sales volume to support a Meijer type store, than that is when you go to that environment. There are myths that people think you need Meijer, a distributor and a website and you will be hunky-dory, but those are the first three things you don't want.

It is not that having a website, distributor and shelf space in a large retail store are bad, according to Mr. Kalchik, but they should come later in the development of the venture. In addition, such stores will not often provide the appropriate margins needed to operate profitably at a small scale. As Mrs. Novak states, "You can't take a unique product that you can make competitive (in a niche market) and put it in a mass market, you have to think about where is it that you can be to get a little more (profit) margins."

Providing advice on how to build one's brand equity and to properly target one's customers, are two examples of how the Product Center can help entrepreneurs develop better business strategies in the business planning process. The full extent of the strategic counseling providing and its benefit to the entrepreneur will again depend on each entrepreneur's personal experience, education and the nature of the venture concept, as well as the relevant skill set of the counselor providing assistance. This being said, for some of the smaller, less experienced clients interviewed in the in-depth interviews, this focus on strategic development

has provided clear benefits. As one grower and specialty agriculture producer commented, “I would still have been able to launch without the Product Center, but the business would have made more mistakes.” While another nascent entrepreneur looking to bring a unique food product to market, who had little experience in the industry, commented on how, “The Product Center was helpful by giving direction on how to put the business plan together and provide general business support.” This leads to the second set of research propositions to arise out of this case study:

Proposition 2

Entrepreneurial Assistance Programs can create value for entrepreneurs by helping them to increase their probability of success and survival through the development of a strategic plan to develop a proprietary competitive advantage through engaging clients in the business planning process.

Engaging in business planning prior to product development, as in the Product Center model, can be very beneficial in the organizing process as most entrepreneurial efforts to exploit new opportunities are based on unsubstantiated ideas and conjectures (Shane, 2003). Planning can test the internal consistency, plausibility and accuracy of the entrepreneur’s ideas about the production process, business governance and product demand by forcing the entrepreneur to clearly articulate her assumptions and beliefs (Harper, 1996). It can also indicate the human, physical and financial resources needed before the acquisition of those resources leading to a reduction in costs occurred from trial and error (Shane, 2003). Planning helps the entrepreneur to determine what information she still needs to obtain (Duchesneau and Gartner, 1990), helps her to clarify and facilitate the achievement of her goals and

objectives (Locke and Latham, 1990; Rousseau, 1997) and ultimately allows her to convey her conjectures and beliefs about the opportunity to others in a systematic and easy to understand fashion (Shane, 2003).

B. Assistance in Acquiring Resources

This is a very important stage where the Product Center can provide benefits to would-be entrepreneurs. The first method by which the Product Center can help entrepreneurs acquire resources is by helping entrepreneurs to better signal the quality and viability of this concept to resource holders and trading partners in a systematic and socially acceptable manner (i.e. a business plan). This will act to reduce information asymmetry concerns, particularly moral hazard and adverse selection, through screening out less committed entrepreneurs who do not wish to put the time and effort into creating a business plan as well as signal the entrepreneur's own skill set and business knowledge through the quality of the document. As one client in the bioeconomy industry remarked, "The Product Center helped with critiquing business plan, getting it more to the point. Developed an offering memo and went out and raised money. The Product Center was very important in getting the business plan written."

At the time, however, the Product Center didn't have a lot of experience in this industry and that client went out to say, "When it came to more, (the Product Center) didn't seem to have the professional expertise to look at it to see how good the ideas were and areas to improve upon." This indicates the value of the process, but that some of the more intangible benefits will depend upon the skill and knowledge of the counselor.

In a related manner, the second way in which the Product Center can help entrepreneurs acquire resources is through helping the entrepreneurs develop a proprietary competitive advantage through the business planning process that can be communicated to resource holders to further signal the viability of the venture concept and reduce some concerns of the uncertainty of the venture's future profitability stream. One large food processing client looking to expand his business remarked how, "The Product Center was helpful to think through the process and to develop the business plan to get the resources that they need." This indicates how focusing on the business planning before attempting to acquire resources can be quite beneficial as many clients often remark how the business plan was instrumental and often required in order to get a loan for their business.

As shown by Shane(2003), business plans, or documents that present the entrepreneur's conjectures in written and visual form, are important tools in overcoming many of the uncertainty and information asymmetry issues in the resource acquisition process (Shane, 2003). Business plans allow entrepreneurs to tell their stories in an institutional way (Zimmerman and Zeitz, 2002), and thereby provide an appropriate platform to reduce the level of information asymmetry to investors.

Business plans also provide a signal of the quality of the entrepreneur and opportunity to investors, which can help overcome adverse selection and moral hazard issues (Shane, 2003). Shane (ibid.) has shown that business plans can provide legitimacy when external validation of the opportunity is difficult (Aldrich, 1999), rationalize the opportunity that is easy for others to accept (Lounsbury and Glynn, 2001), generate confidence (Fisher, 1985) and by convincing resource providers that the opportunity is a reality, making it more likely that the

entrepreneur can get the resources necessary to actually make it a reality (Gartner et al., 1992). However, because business plans are created by entrepreneurs they may tend to be overly optimistic and cause resource holders to wish for additional forms of validation (De Meza and Southey, 1996; Busenitz and Barney, 1997).

Finally, and perhaps most importantly in terms of the unique value that an EAP can provide to clients that they could not have provided for themselves, is through the relationship the Product Center has built with external lenders such as Greenstone Farm Credit Services and Comerica Bank. The Product Center can act as an indirect tie between the entrepreneur and these resource holders to overcome a significant amount of the transaction and agency costs associated with obtaining loans. As Mr. Kalchik describes the relationship with Greenstone, “We work with Greenstone Farm credit, who will give preferential treatment, (but there) still has to be a good business plan, but if someone has been working with a Product Center counselor, they tend to accept it a little more quickly than otherwise.”

This has been the experience of one of the counselors as well who said, in addition to the value for an entrepreneur to use their work with the Product Center as a signal, Greenstone will also, “refer people to the Product Center with the understanding that they will not receive financing until they can complete a business plan with the Product Center.” In the case of food processors, however, as Mr. Birbeck puts it, “Greenstone doesn’t give loans to barbeque-sauce makers, they give it to farmers. Comerica Bank is by far my better loan for small business. We developed a relationship with them, and are promoting small loans for small businesses. They are saying they need a business plan, between me and SBTDC (Small Business and Technology Development Center), I will write the marketing and supply chain and SBTDC will do the finance

for him. They know what they want to see. SBDTC has all the templates for all the financial plan.”

By leveraging the skill sets of different EAPs and the social ties that those EAPs have built with lenders, entrepreneurs can use overcome a lot of the difficulties associated with obtaining financing. Social ties, defined as either a direct relationship between the entrepreneur and the resources provider (Larson, 1992), or an indirect relationship where both parties have a direct relationship to a third party (Burt, 1987) can be very helpful in mitigating problems of uncertainty and information asymmetry through reducing people’s tendency to act in a self-interested manner by adding additional social disincentives (Marsden, 1981; Uzzi, 1996; Granovetter, 1985; Gulati, 1995).

This ability of the Product Center to help reduce transaction and agency costs problems in resource acquisition leads to the third set of research propositions:

Proposition 3

Entrepreneurial Assistance Programs can create value for entrepreneurs by increasing the probability of their clients’ new venture survival and success through assisting clients acquire the resources and trading partners they need by helping clients develop and signal the value of their new venture in an institutionally acceptable manner (i.e. a business plan) as well as by serving as an indirect tie between entrepreneurs and resource holders.

As stated above, an entrepreneurial new venture involves contracting the use of resources at a known price to produce a product or service in the future whose price/demand is unknown at the time of contracting the resources (Knight, 1921). This feature makes removing uncertainty from the entrepreneurial process impossible to do completely. However, by

convincing resource holders that the entrepreneur can develop a competitive advantage that will preclude the dissipation of the opportunity to competitors once she has begun to exploit it, an entrepreneur can help to reduce the concerns associated with the competitive uncertainty of the entrepreneurial process (Shane, 2003).

A good strategy communicated in an institutionalized manner, such as a formal business plan, can act as a strong signal to overcome adverse selection issues as well. Investors can also use attributes of the entrepreneur (founder) and the opportunity expressed in the business plan as a screening mechanism against adverse selection and moral hazard. Research has shown that there are certain characteristics in both founders and opportunities that investors look for (Shane, 2003). For example, investors tend to prefer teams of entrepreneurs to individuals (Roberts, 1991); investors prefer entrepreneurs with a high need for achievement and internal locus of control (McClelland, 1964; Pandry and Tewary, 1979); and investors place a lot of importance on the entrepreneur's level of education (Bates, 1997), and industry, management and start-up experience (Casson, 1982; Amit et al., 1993) as these are all attributes associated with opportunity exploitation and new venture success (Shane, 2003). In regards to opportunity attributes, investors will look for signals such as: evidence of a large market, acceptance of the product or service, appropriate firm strategy, competitive advantage, availability of the raw materials to produce the product, a viable production process, a product prototype, some evidence of external accreditation, endorsements, guarantees, bonds, licenses, or certification of the venture (Low and Abrahamson, 1997; Carter and Van Auken, 1990; Kaplan and Stromberg, 2001; Shane, 2003).

Of particular importance is the ability for an entrepreneur to signal a proprietary competitive advantage that can be demonstrated and externally validated (Bhide, 2000). Even if the entrepreneur is capable and the opportunity valid, without a proprietary competitive advantage that allows the entrepreneur to retain the profits from the opportunity once exploited, the venture may still fail (Shane, 2003).

Lastly, social ties also provide an important mechanism to transfer information and hence reduce information asymmetry (Burt, 1992). Research has found that direct ties increase the likelihood of new ventures to receive financing (Shane and Cable, 2002). For those not fortunate enough to have a direct tie to a resource provider, however, researchers have found that indirect ties can also overcome information asymmetry and uncertainty problems and increase the likelihood of new ventures receiving financing as well (Shane, 2003).

Indirect ties, such as from an entrepreneur to a lender that are both directly tied to the Product Center, can act to transfer the social obligation, behavior expectations and debt of reciprocity that already exists between the directly tied parties (Uzzi, 1996). Investors tend to be more likely to believe in the competence and trustworthiness of those who have been referred (Blau, 1964). Indirect ties also provide a fast and trusted source of information transfer about the quality of the entrepreneur and their opportunity (Fernandez and Weinberg, 1997; Burt, 1992; Kelly, 2000) and will often use the third party's relationship as a bond against opportunism (Coleman, 1990).

The ability of the Product Center to use its reputation as an indirect tie to facilitate trade between resource holders and entrepreneurs is a substantial benefit that an EAP can provide.

As one counselor put it, “The people who go through the process gain from the reputation with the local economic development group.” Given all the aforementioned difficulties inherent in obtaining resources for entrepreneurs, any assistance in this area will be critical in increasing the probability of success for the new venture.

C. Assistance in legitimizing the product and establishing ties to trading partners

Once the planning is done and the product is ready to be developed the Product Center helps entrepreneurs to legitimize their product through the adherence to social norms, rules and regulations. This is done primarily through the assistance of the Specialized Services branch of the Product Center, which helps entrepreneurs adhere to food safety laws, obtain product labeling, receive legal assistance, obtain proper packaging, and receive marketing and distribution advice. Once an entrepreneur has developed their concept definition and business plan then, “there is a to-do list of what has to get done,” according Mrs. Novak. This to-do list is, “a master checklist of tasks such as: product development, food safety, licensing and so on, that might be minimally explored in the concept development stage, but becomes the nuts and bolts of getting (to launch).”(for the complete list of tasks to be done, see exhibit E, Appendix B) As Mrs. Novak further elaborates, “It’s such a task to get it from a kitchen recipe to a commercial recipe, and we haven’t even spoken to the food safety part. It’s one big project after another, and all they want to do is sell it.”

This process often involves, as Mr. Kalchik puts it, “Getting them to scale down their ideas at first into something more realistic.” This will usually involve, in the case of food processors, starting with designing the label. As Mrs. Novak describes this process:

Label is very important, which has legal elements which we have achieved (how to incorporate) through working with the Michigan Department of Agriculture and the other thing is the marketing aspect. The label, they think is sometimes a simple project, but when they start peeling it back it is very critical to their product. First they will hand-sketch this thing, then the big task is getting the hand-sketched label into a real thing. Then finding a graphic designer, then there is the nutritional facts, the ingredients and the whole image thing and the color and the font, it’s a lot of detail and they don’t appreciate the detail and it slows them down.

The Product Center, however, can help speed up this process by assisting entrepreneurs in both figuring out what the steps are and by connecting them to people who can help them complete those steps.

Developing the label is just one aspect of product development, however, and food processors must also: identify the regulatory agencies which will be required for legal sale of the product; determine the food safety parameters of the product to ensure safe and wholesome distribution and sale of product; identify the proper packaging for maximum product shelf-life, cost, marketability and customer convenience; determine the entity which will manufacture the product; and finalize formula (recipe) for commercial production, according to the manufacturer.

To assist in this process, the Product Center has developed direct ties to on and off campus service providers for each step. The key role the Product Center counselor plays is in

determining who the appropriate trading partner, whether it be suppliers, co-packers, distributors or retailers, should be to refer the client on to. As Mr. Birbeck further explains,

The (right trading partners) are all there, what you have to be more careful about, from our point of view is that you don't want to send hundreds of people to suppliers of services that you are not going to get fruition at the end of the day, because you will lose your reputation with that supplier very quickly. You need to triage the client well enough that if you are going to send them to a specific service that they will use it well enough. It's a gamble and trust and relationship and you get that gut feeling that they are ready to do it.

This triaging of clients to different trading partners is important in both the value the relationship will provide to the entrepreneur, as well as the value of the Product Center's reputation. Sending an entrepreneur who isn't ready to engage in commercial production with a particular co-packer, or retailer, for example, will not only prevent that entrepreneur from being able to use that trading partner's services in the future, but will damage the value of the social tie the Product Center has established with the trading partner for future clients as well.

Once an appropriate business plan is in place and the product developed, the entrepreneur will also need to establish the production process to sell the product on a commercial scale, establish the organizational structure of the venture and its employees (Schumpeter, 1934; Nelson and Winter, 1982). This process, occurs over time, and involves such activities as obtaining equipment, establishing production processes, hiring employees and setting up the legal entity for the venture (Katz and Gartner, 1988). The time spent doing this will vary from venture to venture, but on average will take about a year (Reynolds and White, 1997). Most entrepreneurs will engage in this process by basing their routines and structures on what they have learned from their education, previous work experience and example set by other firms

(Aldrich and Von Glinow, 1992; Katz et al., 2000; Klepper, 2001). (For more detail on the organizing process: see Appendix A).

This will also involve conforming to any industry and legal regulations, societal norms and tax codes. Through counseling, market analysis and feasibility studies, the Product Center can provide assistance and external validity to the viability of an entrepreneur's choice of organizing methods before resources are engaged in the launch of the product. This can include obtaining appropriate packaging, food labeling, product testing and legal status as well as counseling clients on what may be the most appropriate production, marketing and distribution outlet given the client's current size and customer demand. In addition, the Product Center can also serve as a direct tie to campus resources such as the packaging school, the law school and product testing office as well as indirect ties to distributors, co-packers and retailers. These social ties, as has been discussed above, can help to mitigate a substantial amount of the transaction and agency costs inherent in the organizing process stage. Taking all this into account leads to the fourth set of research propositions:

Proposition 4

Entrepreneurial Assistance Programs can create value for entrepreneurs by increasing the probability of their clients' success and survival through assisting clients to legitimize their products by adhering to the social norms and regulations of their industry, developing scale appropriate production strategies and serving as a direct tie to EAP service providers and an indirect tie to trading partners.

Though the uncertainty and information asymmetry that is inherent in the entrepreneurial process can cause quite a bit of problems for entrepreneurs, there are many strategies noted in the literature that entrepreneurs and investors can employ to help mitigate

the effect of these problems that support the findings of the case study. In particular, the development of a proprietary competitive advantage, signaling the value of the venture through a business plan and the use of social ties are well documented strategies (e.g. Shane, 2003) that the Product Center helps entrepreneurs to employ to overcome these problems. To overcome the agency issues, entrepreneurs can provide signals and resource holders can use screens to help determine the quality of the entrepreneurs and their opportunities. In relation to the transaction cost issues, entrepreneurs and resource holders can also invest in safeguards to mitigate the risk of opportunism and hold-up (Williamson, 1985).

XI. Case Study: How the Product Center helps to identify and create opportunities

Once the product has been properly developed and is ready for commercial sale, entrepreneurs must then decide on how to coordinate the marketing and distribution channels through which the product will be sold. Here, the value of identifying the market opportunity the entrepreneur wishes to target in the venture concept definition and business planning stages becomes most evident. As was discussed in those sections, without the assistance of the Product Center, many entrepreneurs will often overextend themselves by trying to gain entry into a large retailer without having the appropriate customer base and/or production capacity to be successful in such an arena.

Instead, the Product Center counselors can provide advice how to market their product at a level that is scale appropriate for them. For example, the Product Center may counsel some food processors to take advantage of the recently passed Michigan cottage food law to build

their business more slowly. This law, which according to the Michigan Department of Agriculture, allows entrepreneurs to manufacture and store certain types of “non-potentially hazardous foods that do not require time and/or temperature control for safety” in an unlicensed home kitchen (Michigan Department of Agriculture, 2010). This will be very beneficial for food processing start-ups, according to Mrs. Novak:

Because if an entrepreneur decides they have a product and are not going to make it themselves it's a big financial commitment to engage with a co-packer. They can make it under the cottage food law in their kitchen and just test the market, and try to build some sales and feedback and build a customer base. It's a great way to (1) see if they have the fortitude to do it and (2) build a sales history and then in 6 months start to talk to a co-packer, they can get a better sense of inventory, better sense of who are their customers for smaller stores (instead of Meijer which is further down the road). Building the business slow and having that history is very beneficial.

When its clients are ready to enter into larger retail space, the Product Center also assists in finding and identifying opportunities to do so. By leveraging its name and that of Michigan State University, counselors can gain access to senior executives in some of the region's larger retail stores that an average small to medium size business owner would not be able to get. As Mr. Birbeck states, “I'm always looking for opportunities and I don't use my name but will use MSU's name as that's the Product Center's competitive advantage. If Matt Birbeck walks into Meijer and says can I talk to the president of Meijer they will say no, but if Matt Birbeck of Michigan State University walks in and says that they will tend to say yes.” This access allows them to gain valuable information on what the retailer's needs are, which the Product Center can relay back to clients.

By identifying these opportunities the Product Center can also work with groups of different clients to form an alliance to exploit this opportunity in a way that the large

retailer does not have the time to desire to do themselves. As Mr. Kalchik has explained it, while these growers could have organized themselves to meet this need without the assistance of the Product Center, the indirect tie provided by the Product Center between the can help to reduce a lot of the transaction costs involved in such an alliance, while the access to the retailer's upper management can help reduce the level of information asymmetry in the transaction and facilitate a trade that may not have otherwise occurred.

In addition to helping entrepreneurs identify scale-appropriate retail opportunities the Product Center also works to create opportunities for its clients. As Mr. Birbeck explains, "One thing you can do is to create carrots and opportunities for your clients, because without carrots they will never go through the process." These opportunities can be created by using the University's name, reputation and relationships with different partners such as major grocery retail chains or local hospitals to try to get the appropriate clients into their operations. With retailers, counselors are able to talk to store managers to determine how they are doing, what they need and if they might want to get branded or "buy-local" programs going. Then, for clients that the counselor has confidence could meet the demand of that size retailer, the counselor can inform them of the opportunity and try to "connect the dots."

For example, Mr. Birbeck describes how the Product Center worked with a large hospital in Lansing, "Sparrow is a huge hospital in Lansing that is now being mandated by charter to have healthier options in their cafeterias and stores. (Sparrow) went to their distributors and they didn't have such options and they didn't know how to get such a supply, so there's the gap and the Product Center can help become a resource to fill that gap." In this way, EAPs can create

value for their clients through both the identification and creation of market opportunities for entrepreneur's innovative ideas.

In another instance, the Product Center has worked with the regional retailing giant Meijer to create a "Pure Michigan" branding campaign that Product Center clients can be selected to participate in. According to Mr. Birbeck, "This will be a permanent location in around 50 to 60 stores around the state in which under the Pure Michigan logo these product will be sold. The project is in the final stages of preparation and with a launch date of January 1st 2012."

Therefore, it appears the Product Center is helping entrepreneurs to successfully launch their product by in many ways that can be summarized by the following research proposition:

Proposition 5

Entrepreneurial Assistance Programs can create value for their clients by increasing the probability of their new ventures success and survival through assist its clients in the launch of their products by: (1) Providing counseling on the appropriate scale, distribution and marketing outlets for clients' products; (2) Identifying opportunities that are appropriate to the clients' scale and customer base; (3) Serving as an indirect tie that facilitates the trade of information and goods between entrepreneurs and their trading partners; (4) Serving as an indirect tie between similar entrepreneurs in the formation of alliances to meet identified opportunities; and (5) creating new opportunities for clients' to expand their sales and customer base.

XII. Conclusions

A. How EAPs creates value

In summary, there are many ways in which an EAP can create value for the entrepreneurs who receive its assistance. In the Product Center's venture concept definition and business planning services, the EAP helps to provide a check on the negative impact of cognitive biases through providing external validity, in the form of advice arising out of the tacit knowledge of the counselors as well as the more formal market and feasibility studies. This creates value as relying on certain cognitive biases in a new venture's strategic decision-making process has been shown to reduce the long-term survival and growth probability for that new venture.

The advice given throughout the business planning process can also create value for entrepreneurs by helping them to develop a proprietary competitive advantage. Given the competitive uncertainty that is inherent in the exploitation of entrepreneurial opportunities, it is essential for new ventures to be able to retain the profits associated with exploiting such opportunities even after the value of that opportunity has been signaled to the rest of the market. This is best done proactively in the business planning process before launch as opposed to reactively once competitors start to infringe on a venture's profits. The Product Center's process of formally focusing on strategy both before the decision to exploit and the decision to launch is made helps entrepreneurs to take such proactive steps to identify what their competitive advantage will be. While this may result in many entrepreneurs deciding not to exploit the opportunity or launch their venture, it is better to come to this decision earlier

rather than later when more time and resources have been engaged. For those that do persist to launch their venture, having a clear competitive advantage will increase their survival and growth probabilities.

Similarly, an EAP can create value for entrepreneurs by helping entrepreneurs to legitimize their new venture to overcome many of the problems that the “liability of newness” creates. In addition to assisting clients to develop a competitive advantage, an EAP can help them to communicate that competitive advantage in an institutionally accepted manner (i.e., a business plan) to resource holders and trading partners that the EAP has built relationships with. This creates value by overcoming the adverse selection, moral hazard and transaction costs in financing and supply-chain relationships by both signaling the value of the venture through the business plan and leveraging the social ties of the EAP. Furthermore, the assistance provided in adhering to social norms and regulations such as obtaining appropriate packaging, labeling, legal status and so on, can also act to enhance the new venture’s perception of legitimacy, which in turn will also facilitate better supply chain relationships and customer sales. Therefore, by facilitating an entrepreneur’s ability to obtain access to capital and form beneficial trade relationships, an EAP can dramatically increase the probability of success and survival of the new venture.

Finally, by actively identifying and creating opportunities for their clients, EAPs can create value for entrepreneurs by directly facilitating actual sales of the entrepreneur’s product. This is beneficial in both the decision to exploit and launch phases of the entrepreneurial process as well as the exploitation and launch phases. Identifying opportunities

(or lack thereof) can help entrepreneurs to make better decisions as to their strategic choices, as well as signal to resource holders and trading partners the value of the venture if such opportunities exist. Furthermore, as the actual sales of the product is the driver of the business, increasing opportunities for clients who have the capacity to exploit such opportunities, will act to increase the survival and success rates of an EAP's clients as well (for a complete list of propositions, see table 4, below)

Table 4: Summary of Research Propositions

Proposition	Entrepreneurial Assistance Programs can create value for entrepreneurs by increasing the probability of success and survival of their clients' new ventures by...
1	Helping to provide a check on the negative impact of cognitive biases in strategic decision-making by counseling clients to systematically identify and validate their market opportunity and venture strategy.
2	Assisting clients to develop a strategic plan and a proprietary competitive advantage through engaging clients in the business planning process.
3	Assisting clients to acquire the resources and trading partners the new venture needs to be successful by helping clients to develop and signal the value of their new venture in an institutionally acceptable manner (i.e. a business plan) as well as by serving as an indirect tie between entrepreneurs and resource holders.
4	Assisting clients to legitimize their products by adhering to the social norms and regulations of their industry, developing scale appropriate production strategies and serving as a direct tie to EAP service providers and as an indirect tie to trading partners.
5	Assisting in the launch of their clients' new venture by: 1) Providing counseling on the appropriate scale, distribution and marketing outlets for clients' products; (2) Identifying opportunities that are appropriate to the clients' scale and customer base; (3) Serving as an indirect tie between similar entrepreneurs in the formation of alliances to meet identified opportunities; and (4) creating new opportunities for clients' to expand their sales and customer base.

B. How we can evaluate the value created

The conclusions of this case study have many implications in the future analysis of EAPs. First and foremost, care must be taken to separate out the different types of entrepreneurs as well as the different types of clients. That is to say, since the case has revealed at least two distinct categories of entrepreneurs (lifestyle vs. innovative) with very distinct performance outcomes for their new ventures (survival vs. growth), in the analysis of the benefits provided, both the treatment group (entrepreneurs receiving assistance from an EAP) and the control group (those not receiving assistance) should be separated by category of entrepreneurs and analysis run separately. In addition, the literature suggests and this case study has confirmed that clients will use the services of an EAP in very distinct ways (i.e. intense users vs. casual users). The intense user group will be categorized by those who utilize the services of an EAP throughout most of the new venture creation process whereas casual users will come only for a specific service or two. This can be categorized by what types of services the assisted entrepreneur received (i.e. assistance with venture concept definition, assistance with business planning, assistance with product development and number of sessions of counseling received). It is also apparent that, while all the forms of assistance are hypothesized to positively influence the success and survival of new ventures, the manner in which the assistance influences this will be different depending on what type of assistance was received. For example, those receiving assistance in developing and writing a business plan will be expected to be more likely to receive external financing whereas those receiving assistance in product development and supply chain entry will be more likely to form more beneficial trading relationships and sales growth.

Finally, as selection will be influenced by those who lack what the EAP provides (i.e. business experience, social ties, operational know-how, sales outlets, and beneficial trade relationships), it will be of key importance to control for the endogeneity concerns this will create with any treatment variable. To the degree that the lack of certain skills or resources influence not only the decision to receive assistance but the probability of a new venture's success and survival, if this is not controlled for any estimates of the treatment effect will be biased and inconsistent (most likely with a downward bias). In addition, to the degree that entrepreneurs with greater work ethics and viable entrepreneurial opportunities will be more likely to persist in an EAP's process as well as increase their new venture's overall probability of success, then this will also cause any estimates of the treatment effect to be biased and inconsistent (most likely with an upward bias). Therefore, further research must account for both the sample selection bias and duration bias, as well as separate out distinct clusters of entrepreneurs in order to provide convincing answers to the "how much value EAPs create" question.

C. Implications to the Shane model

While the case study appears to find validation for the majority of the model proposed by Shane (2003) there are a few areas in particular that appear can be improved upon. The first is that entrepreneurial opportunities should be viewed as being created as well as discovered. This can be seen in the manner in which many clients of the Product Center come in with an idea well before any knowledge of a market opportunity. In addition, given the manner in which the development of strategy acts to influence the success and survival of a new venture

this implies that the value of the opportunity is not a static quantity determined completely exogenously from the venture's strategic and operational decisions. If this is true, this also implies that the development of strategy should come before the decision to exploit (even if it is unconscious in the mind of the entrepreneur), as the decision to exploit is an expected utility calculation based in part on the underlying value of the opportunity. Furthermore, there should be more decision nodes (i.e. at each separate process stage there is a decision to go forward), as the value of the opportunity will change and can be updated to the degree of success one has in the execution and launch phases (see table 5 below).

Table 5: Implications to the Shane model

Stage of the Entrepreneurial Process	Changes and Additions to the Shane (2003) model that result from the Case Study
Discovery of an Entrepreneurial Opportunity	Entrepreneurial opportunities are not exogenous to the entrepreneur. Entrepreneurs will often <i>create</i> opportunities by identifying market opportunities for their innovative ideas and developing strategies to exploit and enhance the value of the opportunity.
Decision to Exploit the Opportunity	The development of strategy should come before the decision to exploit is made, as strategy will directly impact the expected value of the opportunity. This decision is also dynamic, in that entrepreneurs must continue to decide to exploit that opportunity at each stage of the process.
Execution of the Opportunity	Third party assistance programs can directly facilitate the ability of an entrepreneur to acquire resources and trading partners through assistance in developing a competitive advantage, legitimizing their product and serving as an indirect tie to resource holders and trading partners.
New Venture Performance	Assistance programs can also facilitate performance by identifying and creating opportunities in the market for their clients, as well as connect clients to other clients in order to meet an identified demand.

D. Future Research Implications

In summary, the case study found that EAPs can create value for its clients through increasing the probability of new venture success and survival through: providing a check on cognitive biases in decision making; assistance in strategic planning and the development of a proprietary competitive advantage; providing services that help to legitimize the client's new venture; serving as an indirect tie to resource holders and trading partners; and identifying and creating opportunities for its clients. Now that this theoretical foundation has been built to answer the question of "How do EAPs create value for entrepreneurs," the next step will be to use this foundation to evaluate "how much" value is created.

In order to accomplish this task, researchers should seek to obtain a large enough sample of both entrepreneurs who have received assistance from an EAP and of those who have not received assistance. In addition, to control for industry and other external environmental factors, it is recommended that researchers restrict their sample to entrepreneurs in the same industry and region. Once a large enough sample (i.e. more than 100 of each group) is obtained, researchers should test for significant differences between the treatment group (those who have received assistance) and the control group (those who have not received assistance). This can be done by first estimating how to control for selection bias, duration bias and the clustering of entrepreneurs. Then, when appropriate controls are put into place, researchers should look to estimate how receiving assistance from an EAP has impacted the survivability, growth and profitability of clients' new ventures through the mechanisms laid out in each of the five research propositions. This can be accomplished by examining the influence EAP assistance has had on the influence of cognitive biases, strategy, legitimacy and social ties in the creation of new ventures, and in turn how each of these elements relate to overall venture performance. Finally, the impact of the EAP will be determined by the extent to which the treatment group, *ceteris paribus*, differs in performance compared to the control group.

APPENDICES

Appendix A: Overview of the Shane (2003) model of the Entrepreneurial Process

Shane and Venkataraman have defined the field of entrepreneurship as “the scholarly examination of how, by whom, and with what effects opportunities to create future goods and services are discovered, evaluated, and exploited,” (Venkataraman, 1997; Shane and Venkataraman, 2000). The general framework of the entrepreneurial process, as established by Shane and Venkataraman (2000), and later was further developed by Shane (2003) involves the identification and evaluation of opportunity; the decision whether or not to exploit it; the efforts to obtain resources; the development of a strategy for the new venture, the process for organizing those resources into a new combination; which will all lead to the ultimate performance of the new venture. This model will be discussed in further detail below, on a step by step basis to provide greater clarity.

A. Role of the External Environment

In the Shane (2003) model, any opportunity must be evaluated in terms of its external environment. This evaluation must consider industry, economic, political, regulatory and social characteristics. Within each of these contexts, certain factors have been found to be more or less favorable to the process of venture formation, survival and success (Shane, 2003; Audretsch, 1991; Bates, 1994; Cooper et al., 1994). The presence of favorable characteristics are likely to positively impact the expected utility of the new venture. According to Shane (2003), factors such as the knowledge conditions, demand conditions, industry life cycles, appropriability conditions, and industry structure will influence the degree to which an industry

can support entrepreneurial activity. Whereas the level of wealth, economic stability, capital availability, and tax rate will affect the economic support; the level of freedom in a society, the strength of property rights, and decentralization of power will enhance the political support; and the beliefs and attitudes of the people will affect the social-culture support for entrepreneurial activity. The manner in which these characteristics influence new venture formation, success and survival will be briefly discussed in further detail as well.

B. Industry effect on Entrepreneurial Opportunities

There has been a lot of research that has found that the level of entrepreneurial activity, defined as the propensity for people to engage in opportunity exploitation through new firm formation, varies significantly across industries (Shane, 2003). For example, Taylor (1996) has found that people engaged in agriculture, construction, distribution or finance were more likely to become entrepreneurs than in other industries. These fields have also been found to be much more supportive of entrepreneurial activity (Cressy, 1996; Reynolds, 1997; Schutgens and Wever, 2000), whereas some industries, such as retail, have been found to be a lot less supportive and have fewer new successful firm formations (Dunkelber et al, 1987). Shane (2003), reports that researchers have, in general, found that characteristics that make industries more or less supportive depend on such factors as: knowledge conditions, demand conditions, industry life cycles, appropriability conditions, and industry structure. The degree to which these characteristics positively or negatively influence entrepreneurial activity is depicted in table 1 and will be discussed in further detail below.

i Knowledge conditions

Knowledge conditions depend on the degree of information sophistication required for industry participation. Characteristics that are positively correlated with entrepreneurial activity include the intensity of research and development (Klepper and Sleeper, 2001), reliance on public sector innovations (Malerba and Orsenigo, 1996) and the lack of uncertainty within the industry (Audrestch, 2001). New firm formation success is also negatively correlated with the size of the firm required to create innovations within an industry (Malerba and Orsenigo, 1996).

ii Demand conditions

Demand conditions reflect the culture, tastes, moods and attitudes of consumers in a particular market. Changes in these conditions can create opportunities for new firm formation as producers need to alter or adapt their products to new demands (Schumpeter, 1934; Kirzner, 1997; Shane, 2003.). High demand or growth within an industry allows new firms to achieve greater scale economies (Shane 2003), increase capacity (Drucker, 1985), exploit market niches (Christiansen and Bower, 1996) and specialize their production (Geroski, 2001). The demand conditions that enhance entrepreneurial opportunities are all positively influenced by market size, growth and segmentation (Shane, 2003).

iii The industry life-cycle

The industry life-cycle refers to the age and development of the market for a particular product. Whenever a new product, marketing method or service is created there is a period of time characterized by a few small firms testing different prototypes of resource recombination

that many larger firms will prefer to wait to see what the market response is (Horvath, et al., 2001; Aldrich, 1999). It will be much more feasible to enter the market than after time progresses and a dominant design is established (Geroski, 1995; Klepper and Graddy, 1990).

iv Appropriability conditions

Appropriability conditions refer to the characteristics of an industry that allow firms to maintain control of the competitive advantage created by their innovation (Shane, 2003). Industries that allow entrepreneurs to patent their product, achieve significant learning curve efficiencies, reward secrecy and gain first-mover advantages will be more supportive of entrepreneurial activity (Cohen and Levin, 1989). In contrast, industries that requires a higher level of complementary assets with trading partners in order to maintain one's competitive advantage, especially in marketing and manufacturing, will be less supportive of new ventures. This is because it is more difficult for new firms to develop these relationships than it is to develop the new product or service (Anton and Yao, 1995). Furthermore, a high degree of complementary assets will lead to a greater exposure to opportunism and hence increase the transaction costs involved (Williamson 1975, 1985, 1986.). Having to safeguard against transaction costs will be more difficult for smaller, more capital constrained firms than larger, more established firms with a greater degree of liquidity and ability to spread risk.

v Industry structure

Industry structure is defined as the set of characteristics that affect the long-term competitive dynamics, cost structure and profitability of an industry. To the degree that an industry is more profitable and/or has low input costs, new firm formation will be more

common. Increased profits and reduced costs give uncertain ventures more leeway in the trial and error process of developing their product or service (Dorfman, 1987; Shane, 2003). However, in industries that are capital or advertising intense or are highly concentrated with a small number of firms dominating the majority of the market share, new firm formation or organizing efforts will be more inhibited. Due to the asymmetric information involved between entrepreneurs and resource providers in the new venture formation process, especially in consideration to capital providers, financing of entrepreneurial activities is often quite problematic (Holmstrom, 1989). Therefore, the more financing that is required for industry survival, the less supportive that industry will be to entrepreneurial activity (Shane, 2003). In regards to advertising intensity, brand names built over time are difficult for new entrants to challenge as are the scale economies in advertising achieved by large firms (Dorfman, 1987; Shane 2003). This can also be compounded in highly concentrated industries where new ventures will be more likely to have to challenge the customer base of large and powerful incumbents (Romanelli, 1989).

C. Macro-Environment Effect on Entrepreneurial Activities

The macro- or institutional environmental characteristics that the new venture operates in also has profound effects on the viability of new ventures. The macro-level effects shape three distinct external environments in which the new venture must operate that transcend the industry-level characteristics. These environments are the economic, political and socio-cultural. These effects are summarized in table 2 and will be discussed in further detail below.

i Economic environment

Entrepreneurial activity will be enhanced in times of economic growth and societal wealth as demand for goods and services will be higher and entrepreneurs will be more able to self-finance their operations or obtain credit (Campbell, 1992; Shane, 2003). In addition, if there is a lot of capital available, lenders will compete with each other to finance entrepreneurs, therefore making it easier to obtain appropriate financing (Amit et al., 1998). Economic stability will also make people more confident in the decisions they make regarding their new venture (Harper, 1997). However, high tax rates, especially in regards to income, capital gains and property taxes, will reduce the level of opportunity exploitation (Shane, 2003) as these will make people less willing to accept the variable earnings associated with self-employment (Hubbard, 1998) and reduce people's perception of the profitability of an entrepreneurial activity (Harper, 1997).

ii Political environment

There are a great many ways in which the political environment can affect entrepreneurial activities ranging from the degree of regulation in one's industry, to the level of infrastructure that has been built, to the incentives and subsidies provided directly. There are a few general "rules of thumb" presented by Shane (2003), however, in that the level of freedom, rule of law, property rights and decentralization of power will all increase the level of opportunity exploitation. This is because strong, centralized governments that restrict freedom and reduce property rights will decrease individuals' internal locus of control, which facilitates the decision to exploit an opportunity (Earl, 1990; Gilad, 1982). In addition, centralized markets

will be inferior to decentralized ones as the central actor will attempt to make all the decisions despite having inferior information when compared to a decentralized model where individuals all make their own decisions (Hayek, 1945).

iii Socio-cultural environment

Finally, the socio-cultural environment, defined as the attitudes, beliefs and norms of the people in the entrepreneurs market will also influence the level of opportunity exploitation. In general, the more a society or culture values self-employed entrepreneurs, the higher level of exploitation one is likely to see. This will also lead to a network effect, as the presence of entrepreneurial role models can help to increase the level of exploitation for nascent entrepreneurs. While specific cultural beliefs and practices, such as Kosher or Halaal food requirements, especially if ignored by the dominant industry in a particular market, also provide fertile ground for an entrepreneur to address through venture formation (Shane, 2003).

D. Existence of Entrepreneurial Opportunities

Given the external environment in which an entrepreneur finds herself, one must then ask, “where do entrepreneurial opportunities within that environment come from?” Starting with the neoclassical understanding of competitive market equilibriums, we must first assume that individuals in the marketplace must make a decision on what to do out of a set of possible (mutually exclusive) alternatives. We further assume that individuals are completely rational and have both complete and transitive preferences and that there is complete information regarding price and quality in the marketplace. Consumers then make consumption decisions which maximize their utility subject to a budget constraint and firms maximize profits subject to

a production function. In a situation where there are no barriers to entry or exit, all agents act as rational price takers and there is perfect information on prices, then we can have a competitive equilibrium as an outcome in which every relevant good is traded and each agent in the market is doing as well as he can, given the actions of other agents (Mas Collé, Winston and Green, 1995, p. 305). Another feature of this competitive equilibrium is that there are no economic profits to be had as each element of production (capital, labor and land) are being paid an appropriate rent equal to their marginal productivity. Entrepreneurial profits, here are taken to be the difference between revenues and expenditures that must also factor in the opportunity costs of one's labor, the land and the use of capital based its next best use. This is to be distinguished from accounting profits which would simply be the difference between revenue and expenditures incurred directly by the venture and typically exclude the opportunity cost of the entrepreneur's time, the interest on capital, the premiums for risk and even potentially the rent of the land. In essence, under these conditions, we have supply meeting demand and very little room for economic growth. This raises the question, if neoclassical economics informs us that the competitive market equilibriums value the cost of the means of production at their marginal productivity, then from where do the economic profits needed for the capitalist to invest in their firm in order to create growth, come from? One answer, as put forth by Frank Knight, in his 1921 seminal work *Risk, Uncertainty and Profit*, is that:

Profit arises from the fact that entrepreneurs contract for productive services in advance at fixed rates, and realize upon their use by the sale of the product in the market after it is made. Thus the competition for productive services is based upon anticipations... Hence it is our imperfect knowledge of the future, a

consequence of change, not change as such, which is crucial for the understanding of our problem. (Knight, 1921)

Knight also clearly distinguishes the difference between risk and uncertainty in this process. In this regard, we can think of “risk” being defined as the certain probability of different known outcomes, whereas as “uncertainty” is the uncertain probability of both known and unknown outcomes. This distinction is important in economics since, as the various profitable insurance industries can attest to, if one knows the probability distribution of a venture’s outcome, even one cannot fully predict what the final result will be, one can either build in a risk premium directly to account for this or, as is more likely, contract with an insurance provider against losses as just another factor to be considered in the production function. This would in turn simply recalibrate supply and demand through the competitive equilibrium process to take this into account, and again leave us with no economic profits. However, in the case where the future is not just risky, but uncertain, then Knight allows profits to be had through the contracting of the means of production at a certain rate now to be used to create a product sold in a future market at a value that exceeds the appropriate economic rents paid for each factor. Thus, profits are possible for those who can successfully predict future market outcomes in the face of uncertainty.

Extending this line of thought, Joseph Schumpeter put forth in his Theory of Economic Development, that what he calls “entrepreneurially profits” are possible those who have “carried out new combinations” of the existing means of production differently, more appropriately and more advantageously (Schumpeter, 1934). In other words, it comes from the entrepreneur’s ability to create new combinations of resources that either more effectively meet consumer’s demand, and hence willingness to pay, or satisfy current demand more

efficiently. This can be done in one of five ways, namely: (1) Produce the same product currently out there at a cheaper rate; (2) Replace one production or consumption good with a suitable alternative at a lower price; (3) Produce a new good which more adequately satisfies existing and previously satisfied needs; (4) Introduce an existing good into a new market; or (5) Produce a completely new good. We can then see how profits are obtained through maintaining the same revenue with decreased expenditures in the first two cases, or through creating a “monopolistic” like pricing structure in the latter three. Schumpeter does warn, however, that “this entrepreneurial profit will perish in the vortex of the competition which streams after them,” Schumpeter, 1934). The parallel with Knight is that, by nature, these new combination of resources have uncertain outcomes, and hence by no means guaranteed to be successful. The difference is that Knight would have the entrepreneur be the residual claimant to the result of the venture’s uncertain outcome, whereas Schumpeter would place the residual claimancy on the capitalist who funds the venture (even if it is in fact the same person), leaving the entrepreneur’s role to be one who simply finds the new combinations. In either case, however, profits come from the venture’s novel combinations of resources in the face of uncertainty that allows for the marginal productivity of the resources to exceed their market determined marginal costs.

In short, Knight and Schumpeter paint a picture where entrepreneurial profits arise out of competitive market equilibriums due to the entrepreneurs ability to innovate new products and/or production practices that allow the entrepreneur to obtain a superior position in the market and thus are able to gain greater returns to resources than they price they must pay to utilize those resources. Any innovation, however, involves uncertainty that the market will

respond favorably. This uncertainty is what allows for resources to be undercosted, but once the uncertainty is removed (i.e. the venture is successful), the old rules of the market have been destroyed through what Schumpeter terms “creative destruction” and the market adapts to the new rules making the entrepreneurial profits disappear and the market return to a state of equilibrium again.

This model, though allowing for new information to enter through entrepreneurship, still rests on the neoclassical idea of perfect information as to the price and availability of resources in the market. By contrast, the Austrian approach as first laid out by Von Mises and Hayek, and later expounded by Kirzner, challenges this notion of markets being in competitive equilibrium with perfect information. Instead, they adopt an approach that views markets as starting in a state of disequilibrium (i.e. resources not being deployed at Pareto Optimal uses) and participants having imperfect information but moving towards equilibrium as market participants acquire better knowledge of supply and demand attitudes through the process of entrepreneurial discovery. For Von Mises, this is done through the actions of “enterprising men... eager to profit from discrepancies in the price structure” (Von Mises, 1949) These discrepancies are not brought about from incomplete information, such as would be the case if a merchant in Chicago, for example, was unsure what a price a merchant in New York was charging for a similar product. But rather, these discrepancies arise from that of “sheer” (i.e., unknown) ignorance (Kirzner, 1997). That is where one doesn’t even know what one doesn’t know. This appears to echo Knight’s view of uncertainty in regard to the outcome of a new venture. Entrepreneurial discovery consists of finding new methods to utilize resources to better meet demand. Successful new ventures then educate the market participants and act as

an equilibrating force to move the market closer to equilibrium. That these discoveries are possible can then only be attributed to “errors” of previous entrepreneurs not utilizing resources correctly and/or changes in tastes, resource availabilities and known technological possibilities. The idea of “entrepreneurial profits” becomes an incentive to remove any errors currently in the system. (Kirzner, 1997).

In summary, whether markets are believed to be in equilibrium or not, entrepreneurial profit can be had if one can discover new ways to utilize the means of production to satisfy current demand or create new demand. These new ways to utilize resources that allows for greater returns than their economic cost is what can be considered an entrepreneurial opportunity (Casson, 1982).

E. Discovery of an Entrepreneurial Opportunity

The Shane (2003)² framework then examines how opportunities are discovered and why some discover these opportunities and not others. The answer given by Shane et al (2000) is that it is due to the possession of unique information on the part of the entrepreneur that allows him to see opportunities where other resource holders or competitors do not. This information is not evenly distributed due to the specialization of information in society (Hayek, 1945), and therefore not all market participants are in possession of all the relevant information at the same time with only a subset of the population able to discover a given opportunity (Kirzner, 1973). This leads people to make decisions on the basis of other things

² Note: Most of the following references in the sections explaining Shane’s (2003) model are cited by Shane to support his theory.

besides information alone, such as hunches, intuition, heuristics and even inaccurate information causing their decisions to be incorrect some of the time. These incorrect decisions lead to “errors” of shortages, surpluses or misallocated resources (Shane and Venkataraman, 2000.) Additionally, technological, political, social, regulatory and other types of change are continually adding and updating the potential use of available resources, and hence forcing economies to operate in constant state of disequilibrium while simultaneously creating the need for new information in market participants’ decision-making processes (Schumpeter, 1934). Also, the continual change in buyer preferences and needs further exacerbates this disequilibrium by changing the price (demand) people are willing to pay for different products and services. Moreover, due to our imperfect knowledge of the future, the new venture’s probable future profitability has a large degree of Knightian uncertainty to it. This allows profits to be had through the contracting of the means of production at a certain rate now to be used to create a product sold in a future market at a value that exceeds the appropriate economic rents paid for each factor (Knight, 1921).

These factors then combine to create the possibility of an entrepreneurial opportunity, the discovery of which occurs when an individual perceives he is able to utilize his unique information set to determine that a particular set of resources could be recombined in a novel way to obtain greater returns than those resources’ current underlying economic rents (Shane and Venkataraman, 2000). This opportunity does not have to necessarily turn out to be profitable, so should not be thought of as a Schumpeterian rent, but does require the creation of a new means-end framework instead of optimizing within a current framework (Shane, 2003).

F. Decision to Exploit an Entrepreneurial Opportunity

Alert individuals who discover these opportunities must then evaluate whether or not they wish to become entrepreneurs in order to attempt to exploit that opportunity. To do so, the entrepreneur uses her unique information set, along with certain cognitive characteristics on how she perceives the future expected value of an uncertain venture, to evaluate and determine if she wishes to actually pursue the opportunity. Given the uncertain nature of an opportunity and the asymmetric and incompleteness of information available to market participants, the decision to exploit this opportunity cannot be made through the neo-classical constrained optimization process in response to a given set of alternatives (Baumol, 1993). Instead, citing the work of Kirzner and Schumpeter, Shane and Venkataraman describe this decision in the more familiar economic grounds of an expected utility calculation:

The exploitation of an entrepreneurial opportunity requires the entrepreneur to believe that the expected value of the entrepreneurial profit will be large enough to compensate for the opportunity cost of other alternatives (including the loss of leisure), the lack of liquidity of the investment of time and money, and a premium for bearing uncertainty (Kirzner, 1973; Schumpeter, 1934; from Shane and Venkataraman, 2000).

In essence, once an individual feels she has discovered an opportunity to make entrepreneurial profits, she must then use her current information set and risk-preferences to evaluate whether she wishes to commit the time and resources required to attempt to exploit such an opportunity. The perceived expected value of the entrepreneurial profit to the entrepreneur deciding whether or not to exploit it, according to Shane (2003), will be influenced by three factors: the nature of the opportunity and its external environment,

psychological factors such as risk aversion and cognitive biases, and non-psychological characteristics of the entrepreneur. Each will be discussed below.

i Non-Psychological factors

The non-psychological factors that influence the expected value of the entrepreneurial activity can be thought of as those factors that will either increase the expected returns of the opportunity or those that will increase the relative expected cost of exploiting the opportunity to the entrepreneur. In general, the expected returns of the opportunity will be greater for those entrepreneurs who have greater education levels (Casson, 1995), career experience (Shane and Khurana, 2001), general business experience (Klepper and Sleeper, 2001), functional experience in areas such as marketing, finance, product development and management (Roberts, 1991), experience in the relevant industry (Knight, 1921; Von Mises, 1949), previous experience starting up a business (Jovanovic, 1982), and their social status and amount of social ties (Stuart et al., 1999). Age also has a significant effect, though it is not directly positive or negative, but curvilinear, increasing the likelihood to exploit an opportunity initially as one gains more experience but later as an entrepreneur gets older, and is less willing to bear uncertainty will have a negative effect (Boyd, 1990).

In addition to the factors that increase the value of the opportunity, there will also be those that increase its expected cost. In general, the expected cost will be greater for those entrepreneurs who: have higher opportunity costs to their time such as with a high paying job they would have to leave to exploit the opportunity (Amit et al., 1993), have lower levels of income or savings that could be put at risk to exploit the venture (Taylor, 1996), and don't have a married spouse that can provide some income certainty (Butler and Herring, 1991).

ii Psychological characteristics

Given that less than 50% of new businesses survive for more than five years (Cooper, Woo and Dunkelberg, 1988), it was first hypothesized that entrepreneurs must have a high propensity for risk or place a higher utility on the use of new ventures to satisfy their need for achievement (McClelland, 1964) over their profit capabilities. However, further research has found little evidence for an “entrepreneurial profile” that such hypotheses would suggest is inherent in those willing to take such long odds. Some more recent studies have found that entrepreneurs simply perceive less risk as being involved (Simon, Houghton, and Aquino, 2000) or are more subject to cognitive biases that cause an individual to overestimate the expected utility of a new venture (Baron, 2004).

As economists, we are tempted to assume that individuals make perfectly rational decisions based on their information set. This is a convenient assumption that allows for constrained maximization models to function properly. However, in reality, we know that individuals facing uncertainty have certain heuristics and biases that also influence their decision-making processes (Busenitz & Barney, 1997). More importantly, these heuristics and biases vary across individuals and will have a significant impact on who decides to become an entrepreneur and the probability of success of the venture (Venkatraman, 1997). This variation is useful in determining not only why some individuals become entrepreneurs when others don't, but also in evaluating why some ventures fail and others do not. Specifically, though certain biases and heuristics will increase the likelihood of deciding to exploit a perceived entrepreneurial opportunity, it can also negatively impact the probability of success of that

entrepreneurial opportunity if the entrepreneur does not fully appreciate the costs or risks involved and take appropriate measures to deal with them.

One well documented bias individuals often have is known as Prospect Theory. This bias centers around the different weights individuals place on gains versus losses. In particular, prospect theory hypothesizes that the slope of the subjective utility function an individual places on losses is steeper than the slope placed on gains (Baron 2004). For example, imagine a situation where one had the opportunity to choose from taking a \$500 check, no questions asked, versus playing a game of double or nothing with the \$500 based on a coin flip. Prospect theory would predict that most individuals would choose to have the sure thing. However, if the game were reversed, and one had the choice between paying \$500 or having an opportunity to double or nothing the debt, many more individuals would opt to take the gamble. In both situations, the expected value of the gamble is the same (i.e. \$500). The subjective value an individual places on the benefit of the gamble, however, is quite different. Namely, in the first situation one has the opportunity to gain an additional \$500, which is valued less than the second situation where one has the opportunity to reduce one's loss by \$500. In terms of entrepreneurs, to the extent that they view not acting on a potential entrepreneurial opportunity as a loss of potential revenue that could be had if exploited, versus looking at the opportunity as a source of potential returns for one's current set of resources, then they will be more likely to place a higher subjective utility on the decision to exploit that opportunity (Baron, 2004). Prospect theory also suggests that people overweight small probabilities, such as with the millions of state lottery players who are willing to pay \$1 for a ticket whose expected value is often quite less than the dollar they are paying (Baron, 2004). So

though most new ventures fail (Cooper, Woo and Dunkelburg, 1988), many entrepreneurs will cite examples from notable exceptions such as Google, Facebook or more recently Groupon as a justifiable counterpoint to why they can disregard such statistics.

Other errors of thinking, or cognitive biases, pointed to by Baron (2004) include such things as the optimistic bias – which is an overweighting of positive outcomes (Shepperd et al, 1996), the confirmation bias – which is the tendency to only pay closer attention to information that confirms our current beliefs (Kolchinski, 2001), the planning fallacy – a belief that we can get more done in an allocated time interval than is actually possible (Buehler et al, 1994), the illusion of control – the tendency to believe one's own skill can influence outcomes even when random chance plays a significant role (Simon et al, 2000) and the law of small numbers – using a small sample size to draw general conclusions (Simon et al, 200). All of these biases have the potential to increase the perceived expected utility of an entrepreneurial opportunity to an individual considering whether to exploit it.

In fact, it may be that due to the low odds of successfully discovering and exploiting an entrepreneurial opportunity, a certain amount of cognitive bias is necessary to prevent the entrepreneur from either never attempting to launch the venture or giving up too early during the initial development stages that are likely to have low or negative returns (Baron, 2004; Simon et al, 2000). This might explain why some have found these biases to be quite common among entrepreneurs (Busenitz and Barney, 1997). However, some have suggested that, though a certain amount of cognitive bias is helpful, successful entrepreneurs are better able than the unsuccessful ones to provide a counterbalance to these biases in order to hold them in check (Baron, 2004; Simon et al., 2000). The more that the entrepreneur can build and engage

“safety nets” that provide checks on whether a cognitive bias is leading them down a potentially negative path, the more successful they will be at exploiting an entrepreneurial opportunity (Simon et al, 2000). This is because, though these biases help individuals when making complex and uncertain decisions (Schwenk, 1984), they may result in those entrepreneurs making decisions that are not well thought or appropriate to the problem at hand (Barnes, 1984). In addition, the more an entrepreneur can think counterfactually and systematically and avoid other biases, such as the attachment to sunk costs, the better decisions they are likely to make and hence better probability of success for the new venture (Baron, 2004, see table 3 below for Baron’s comparing why some individuals but not others become entrepreneurs vs. why some entrepreneurs but not others succeed).

Table A-1 Cognitive factors relevant to three basic issues addressed by the field of entrepreneurship (Relevant cognitive factors are listed under each question)

Why do some persons but not others become entrepreneurs?	Why are some entrepreneurs more successful than others?
<i>Reduced perceptions of risk</i> Persons who become entrepreneurs perceive risks as smaller than other persons do	<i>Counterfactual thinking</i> Successful entrepreneurs are better than less successful ones at using counterfactual thinking to formulate improved task strategies
<i>Prospect theory</i> Persons who become entrepreneurs overweight small probabilities Risk-averse to gains, risk-seeking to losses	<i>Processing styles</i> (Systematic vs. heuristic) Successful entrepreneurs are better at switching between these two processing styles
<i>Greater susceptibility to various cognitive biases</i> Optimistic bias, affect infusion, planning fallacy, and illusion of control, law of small numbers, confirmation bias.	<i>Reduced susceptibility to certain cognitive biases</i> Successful entrepreneurs are more successful at avoiding biases such as sunk costs

From Baron, The cognitive perspective: a valuable tool for answering entrepreneurship's basic "why" questions, 2004.

G. Resource Acquisition

Once the decision has been made to exploit the opportunity, the entrepreneur must execute the opportunity by gathering appropriate resources, developing business strategy and designing an organizational structure (Shane, 2003). However, in order to successfully exploit an opportunity, an individual must not only overcome whatever cognitive biases they have and

adapt their venture to the external environment, but he must also be able to successfully acquire and utilize the appropriate resources in the actual business operations. The set of skills required to do this, however, are often quite different than those required in order to discover an opportunity and make the decision to exploit it. Furthermore, entrepreneurs often have a lot of difficulty in obtaining the appropriate resources for their venture due to their small size, inexperience, lack of a track record, entrepreneurial opportunity uncertainty and asymmetric information problems. This may provide insight into why so many new ventures fail. In order to exploit a new venture, there are many types of resources an entrepreneur must acquire. These include physical equipment, land and human capital, but perhaps the most important capital required before launch of the new venture is financial capital. Since the recombination of resources inherent in the exploitation of an entrepreneurial activity must occur before the sale of the output, this exploitation must be financed (Shane, 2003). The majority of the time this takes the form of self-financing (Aldrich, 1999). External financing is also available in the form of equity investment which would include funding from angel investors and venture capitalists, debt-financing, asset-based financing and governmental or non-profit grants. Whatever the source may be, however, there are two basic characteristics that make the resource acquisition process for entrepreneurs difficult – uncertainty and information asymmetry (Shane, 2003). Overcoming the issues associated with uncertainty and information asymmetry (see figure 3 below) is important because the obtainment of capital has been shown to make new venture more likely to survive and become profitable through having a buffer against adverse situations (e.g. Carroll and Hannan, 2000; Ranger-Moore, 1997; Banaszak-Holl, 1991) and removing liquidity constraints on the possible actions the venture might take (Shane, 2003). Therefore,

the following sections will discuss in more detail the problems and solutions associated with uncertainty and information asymmetry in regards to resource acquisition.

i Consequences of Uncertainty

Entrepreneurial opportunities are, by definition, uncertain because the profitability associated with the new resource combination is unknown before the launch of the venture (Arrow, 1974). In addition, for entrepreneurs without observable track records or products, resource providers must make financing decisions on very little information and their own intuition (Bhide, 2000). Due to this limited information and evidence, investors face high risk in financing entrepreneurial opportunities (Low and Srivatsan, 1994), which can result in high interest rates on loans to cover this risk or the inability to get a loan at all.

The uncertainty of the new venture's profit stream also creates difficulties in determining the net present value of the venture, which can lead to differences of opinion about the venture's value between the entrepreneur and the lender (Wu, 1989). This can create bargaining problems, and result in the resource provider offering less than what the entrepreneur believes is the value of the opportunity (Shane, 2003). Furthermore, resource providers might wish to have collateral (Blanchflower and Oswald, 1998) against default if the entrepreneur fails and cannot pay back the loan (Casson, 1982). This will pose significant problems for those entrepreneurs without suitable collateral to offer.

ii Consequences of Information Asymmetry

Information asymmetry, defined in this case where the entrepreneur holds more information about the value of the opportunity and her own dedication and work ethic in regards to exploiting it, creates four major obstacles to capital acquisition (Shane, 2003).

The first comes from the natural tendency of entrepreneurs to want to keep key information about the value of and the method for exploiting an opportunity. Making this information known could cause others to attempt to exploit it as well, thus bidding up the requisite resource prices associated with that opportunity (Casson, 1982) or may cause the resource providers to exploit it themselves. This secrecy leads to resource providers to make decisions with incomplete information, and may cause them to refuse to finance the venture or not provide enough financing as is needed (Shane, 2003).

Second, this information asymmetry also allows for opportunism on the part of the entrepreneur through obtaining more resources than their venture deserves (Shane and Cable, 2002) or by getting better concessions on the investments or loans than a resource provider with a full information set would allow (Shane, 2003).

Third, there is also some moral hazard risk in the entrepreneur engaging in unnecessarily risky behavior once he has received the loan, or not putting forth an appropriate effort level as is required to fully exploit the opportunity. This, in turn, will make resource providers take safeguards against opportunism and increase the transaction costs involved in obtaining financing (Williamson, 1975; 1985; 1986). These safeguards often involve resource providers offering fixed rate financing at high interest rates so the entrepreneur bears the risk. At high rates, however, entrepreneurs will be more likely to favor risky projects with high

potential returns (Barzel, 1987) as low to moderately risky projects with low to moderate returns will be less likely to be profitable, given the high interest rates with the cost of default to the entrepreneur being the same in any situation.

Lastly, given there is a range of ability in both discovering and exploiting entrepreneurial opportunities, those who are less skilled at doing so will seek financing in addition to those that are more skilled. If the resource provider cannot distinguish between the varying skill levels, then this can create a “market for lemons” (Akerlof, 1970) and lead to adverse selection in the lending market (Amit et al, 1990). This will have the net effect of lenders either refusing to participate in the lending market, or participating only by offering interest rates appropriate for less skilled individuals. Since they are less skilled, and therefore more likely to default, these rates will be significantly higher than would be appropriate for those who are more likely to succeed in their new venture, potentially to the point of being cost-prohibitive.

iii Strategies to Mitigate Resource Acquisition Difficulties

Though the uncertainty and information asymmetry that is inherent in the entrepreneurial process can cause quite a bit of problems for entrepreneurs, there are many strategies entrepreneurs and investors can employ to help mitigate the effect of these problems.

Mitigating uncertainty

As stated above, an entrepreneurial new venture involves contracting the use of resources at a known price to produce a product or service in the future whose price/demand is unknown at the time of contracting the resources (Knight, 1921). This feature makes removing

uncertainty from the entrepreneurial process is impossible to do completely. However, there are many strategies that entrepreneurs and resource holders can engage in to reduce the level of uncertainty.

Due Diligence

Resource holders can engage in collecting information about entrepreneurs and their proposed opportunities before investing to weed out potentially low quality projects and/or entrepreneurs (Sahlman, 1990). This can also help to reduce the potential for adverse selection (Barry, 1994) because it reduces the level of asymmetric information held by the entrepreneur (Van Osnabrugge, 2000) and can increase the overall odds of success of the pool that survives the due diligence process.

Syndication

By spreading their investment over a lot of different projects, investors can manage uncertainty through diversification (Shane, 2003). This diversification allows the investor to spread the risk in a way that the entrepreneur cannot, thereby mitigating some of the negative impacts mentioned above.

Business Planning

Business plans, documents that present the entrepreneur's conjectures in written and visual form, are important tools in overcoming many of the uncertainty and information asymmetry issues in the resource acquisition process (Shane, 2003). Business plans allow entrepreneurs to tell their stories in an institutional way (Zimmerman and Zeitz, 2002), and thereby provide an appropriate platform to reduce the level of information asymmetry to

investors. They also provide a signal of the quality of the entrepreneur and opportunity to investors, which can help overcome adverse selection and moral hazard issues (Shane, 2003). Business plans can provide legitimacy when external validation of the opportunity is difficult (Aldrich, 1999), rationalize the opportunity that is easy for others to accept (Lounsbury and Glynn, 2001), generate confidence (Fisher, 1985) and by convincing resource providers that the opportunity is a reality, make it more likely that the entrepreneur can get the resources necessary to actually make it a reality (Gartner et al., 1992). However, because business plans are created by entrepreneurs they may tend to be overly optimistic and cause resource holders to wish for additional forms of validation (De Meza and Southey, 1996; Busenitz and Barney, 1997).

Entrepreneurial Strategy

By convincing resource holders that the entrepreneur can develop a competitive advantage that will preclude the dissipation of the opportunity to competitors once she has begun to exploit it, an entrepreneur can help to reduce the concerns associated with the competitive uncertainty of the entrepreneurial process (Shane, 2003; to be discussed in further detail below). A good strategy can act as a strong signal to overcome adverse selection issues as well.

Real options approaches to investing

Also known as staged financing, real options provide investors the right, after making a small initial investment, to make future investments in the venture (Shane, 2003). This reduces the risk of uncertainty, because if the initial results prove negative the investor can refuse to

invest further (Sorenson and Stuart, 2001). However, if the results are positive then the investor can continue to make additional investments. This staging can help to overcome adverse selection (as a screening tool) and mitigate moral hazard by allowing the investor to exit with smaller losses if the entrepreneur fails to put forth an appropriate effort level (Sahlman, 1990). This will also reduce the threat of hold-up by lowering the financial gain to the entrepreneur of opportunistic behavior in the early stages of the venture, while allowing the venture's physical assets to act as a safeguard in later stages (Neher, 2000).

Mitigating Uncertainty and Information Asymmetry Problems

As discussed above, the presence of information asymmetry and uncertainty in the process also causes a host of other problems for entrepreneurs seeking resources for their new ventures. These problems occur both *ex-ante*, before the contracting of the required resources, and *ex-post*, after the resources have been contracted and are being put to use. These information asymmetry related problems can be classed into two categories: transaction cost problems and agency problems. Each category has its own set of strategies to mitigate their associated problems. Given the uncertainty of new ventures, the range of skills of entrepreneurs, the range of values of opportunities and information asymmetry on the part of the entrepreneur, resource holders are likely to worry *ex-ante* about adverse selection and *ex-post* about moral hazard as discussed above (Knight, 1921). In addition, uncertainty interacting with information asymmetry, bounded rationality and incomplete contracts will also expose trading partners to transaction costs problems such as *ex-ante* opportunism and *ex-post* hold-up (Williamson, 1985). To overcome the agency issues, entrepreneurs can provide signals and

resource holders can use screens to help determine the quality of the entrepreneurs and their opportunities. In relation to the transaction cost issues, entrepreneurs and resource holders can also invest in safeguards to mitigate the risk of opportunism and hold-up. A lot of these strategies overlap and have been discussed above in relation to reducing uncertainty as well as information asymmetry. Ones not discussed above will be discussed below.

Self-financing, Credible Commitments and Equity in Venture

One way to ensure investors and resource holders about an entrepreneur's commitment to the new venture is if the entrepreneur himself has made a large irreversible investment in it (Venkataraman, 1997). This mitigates moral hazard through making the returns contingent on the entrepreneur, and adverse selection by the signal provided as to the entrepreneur's belief in the value of the opportunity (Amit et al., 1998). Unfortunately, most entrepreneurs don't have sufficient assets to self-finance. In addition, self-financing exposes the entrepreneur to all the downside risk of the venture, which could potentially hinder risk-averse individuals (Shane, 2003).

Contractual Solutions

There are many types of contractual solutions, such as: convertible securities, covenants against certain activities, forfeiture and anti-dilution provisions, and limits to explicit contracting that can also act as a screening mechanism for resource holders against moral hazard and adverse selection (Shane, 2003). These contracts can weed out lower quality entrepreneurs or opportunities through removing the financial incentives to shirk, but due to the uncertainty involved and bounded rationality will be necessarily incomplete and still not

overcome a lot of the transaction cost issues involved (Williamson, 1985). Nor can they completely remove the incentive for entrepreneurs to act against the interests of investors (Venkataraman, 1997; Arrow 1974) or shift all the risk onto the entrepreneur without essentially making the entrepreneur self-finance (Shane, 2003).

Specialization and Geographically localized investment

To overcome the limits of contracts, investors and resource holders will often specialize in certain industries and geographic locations in order to reduce the level of information asymmetry (Shane, 2003). By specializing in certain industries and locations, resource holders can increase their ability to select and monitor which ventures to invest in (Barry, 1994) as well as generate contacts with suppliers, customers, operating firms and technical experts that can provide information on the entrepreneurs and opportunities they wish to invest in (Sorenson and Stuart, 2001). Geographic concentration can also provide convergent validity for an idea if the investor receives similar validating information from a lot of different sources (Sorenson and Stuart, 2001).

Social Ties

Social ties, defined as either a direct relationship between the entrepreneur and the resources provider (Larson, 1992), or an indirect relationship where both parties have a direct relationship to a third party (Burt, 1987) can be very helpful in mitigating problems of uncertainty and information asymmetry through reducing people's tendency to act in a self-interested manner by adding additional social disincentives (Marsden, 1981; Uzzi, 1996; Granovetter, 1985; Gulati, 1995). They also provide an important mechanism to transfer

information and hence reduce information asymmetry (Burt, 1992). Research has found that direct ties increase the likelihood of new ventures to receive financing (Shane and Cable, 2002). For those not fortunate enough to have a direct tie to a resource provider, however, researchers have found that indirect ties can also overcome information asymmetry and uncertainty problems and increase the likelihood of new ventures receiving financing as well (Shane, 2003). Indirect ties can act to transfer the social obligation, behavior expectations and debt of reciprocity that already exists between the directly tied parties (Uzzi, 1996). Investors tend to be more likely to believe in the competence and trustworthiness of those who have been referred (Blau, 1964). Indirect ties also provide a fast and trusted source of information transfer about the quality of the entrepreneur and their opportunity (Fernandez and Weinberg, 1997; Burt, 1992; Kelly, 2000) and will often use the third party's relationship as a bond against opportunism (Coleman, 1990).

Founder and Opportunity Attributes

Finally, investors can also use attributes of the entrepreneur (founder) and the opportunity as a screening mechanism against adverse selection and moral hazard. Research has shown that there are certain characteristics in both founders and opportunities that investors look for (Shane, 2003). For example, investors tend to prefer teams of entrepreneurs to individuals (Roberts, 1991); investors prefer entrepreneurs with a high need for achievement and internal locus of control (McClelland, 1964; Pandry and Tewary, 1979); and investors place a lot of importance on the entrepreneur's level of education (Bates, 1997), and industry, management and start-up experience (Casson, 1982; Amit et al., 1993) as these are all attributes associated with opportunity exploitation and new venture success (Shane, 2003).

In regards to opportunity attributes, investors will look for signals such as: evidence of a large market, acceptance of the product or service, appropriate firm strategy, competitive advantage, availability of the raw materials to produce the product, a viable production process, a product prototype, some evidence of external accreditation, endorsements, guarantees, bonds, licenses, or certification of the venture (Low and Abrahamson, 1997; Carter and Van Auken, 1990; Kaplan and Stromberg, 2001; Shane, 2003). Of particular importance is the ability for an entrepreneur to signal a proprietary competitive advantage that can be demonstrated and externally validated (Bhide, 2000). As will be seen below, even if the entrepreneur is capable and the opportunity valid, without a proprietary competitive advantage that allows then entrepreneur to retain the profits from the opportunity once exploited, the venture may still fail (Shane, 2003).

H. Entrepreneurial Strategy

In addition to gathering the appropriate resources, an entrepreneur must also develop a consistent business strategy in order to properly execute the entrepreneurial opportunity. Shane (2003) notes that entrepreneurial strategy does not consider those strategies that are aimed at improving the efficiency of existing operations, such as strategies to minimize transaction or agency cost, but rather are concerned with those strategies that allow the entrepreneur to retain the entrepreneurial profits she has exploited by developing a proprietary competitive advantage and managing the uncertainty and information asymmetry issues inherent in the exploitation process.

i Developing a proprietary competitive advantage

As was discussed above, a successful exploitation of an entrepreneurial opportunity will ultimately result in the new venture earning profits above the economic rents associated with the factors of production. However, the returns to the exploitation will disappear to competitors and resource holders unless the entrepreneur is able to develop a proprietary competitive advantage (Shane, 2003). A proprietary competitive advantage consists of some mechanism that prevents competitors from imitating and exploiting for themselves the opportunity the entrepreneur has identified and developed into a new venture. Shane (2003) explains that the returns are expected to dissipate for three reasons: (1) The factors that created the initial opportunity will be replaced by different social, technical and regulatory change that will generate new opportunities in place of the old ones (Schumpeter, 1934); (2) Once the opportunity is successfully exploited resource holders will raise their prices to extract some of the entrepreneurial profits for themselves (Kirzner, 1997); and (3) most importantly, opportunities are exhausted by competition (Shane, 2003).

While the whole entrepreneurial process is aimed at exploiting an opportunity that others have not seen, by the very act of a successful exploitation, the entrepreneur signals to the rest of the market how to identify and exploit that opportunity (Campbell, 1992). This signal of profit acts like blood in the water for sharks giving incentive to competitors to bid for the resources necessary to exploit the opportunity (Casson, 1982). This bidding will cause the underlying resource prices to rise until the profitability of the opportunity is exhausted (Schumpeter, 1934; Shane and Venkataraman, 2000).

In order to prevent this, an entrepreneur can develop a proprietary competitive advantage if she can engage in a secrecy strategy that prevents others from gaining access to or understanding the underlying information that gave rise to the opportunity (Rumelt, 1987). This works best when the exploitation of the opportunity involves a significant amount of technical knowledge that can be kept as a trade secret (Shane, 2003). This can also work if there is a great deal of causal ambiguity (Barney, 1991) and tacit knowledge involved in how the competitive advantage is developed (Shane, 2003).

The problem with the secrecy and causal ambiguity approaches is that secrecy can be breached, others can learn tacit knowledge (Casson, 1982), and people can imitate the entrepreneur's opportunity exploitation path (Rumelt, 1987). Therefore, the entrepreneur must develop barriers and impediments to imitation in order to preserve the profits for themselves (Rumelt, 1987; Casson, 1982; Shane, 2003). There are five common ways in which Shane (2003) states that entrepreneurs will develop these barriers. These five methods are: (1) seize control of the necessary resources (Casson, 1982), which can be quite difficult to fully achieve; (2) establish legal barriers to imitation (Casson, 1982; Shane and Venkataraman, 2000); (3) gain economies of scale that deter new entrants (Casson, 1982); (4) develop a customer loyalty and brand reputation (Casson, 1982); and (5) innovate to stay ahead of the competition (Shane, 2003). Though not explicitly stated, an entrepreneur can also gain first-mover advantages such as: network effects, name recognition and learning curve efficiencies in a new market that will also deter imitation (Lieberman and Montgomery, 1988).

ii Uncertainty in the Execution Phase

According to Shane (2003) there are three types of uncertainty involved in the execution process that the entrepreneur must develop an appropriate strategy to mitigate. These are: technical, market and competitive uncertainty. The technical uncertainty that is present comes from the fact the entrepreneur does not know if the final product will be functional nor if it can be produced at a cost less than its ultimate sale price (Amit *et al.*, 1990). The market uncertainty comes from the fact that entrepreneur is uncertain as to whether there will be enough of a demand, in large enough volumes, at a quick enough adoption and a high enough price in order to make the new venture profitable (Amit *et al.*, 1990). While the competitive uncertainty comes from the fact that the entrepreneur is uncertain as to whether she can appropriate the entrepreneurial profits for herself instead of them being dissipated to competition as described above (Amit *et al.*, 1990).

iii Strategies to manage uncertainty and information asymmetry

Given the uncertainty and information asymmetry issues that are inherently involved in the entrepreneurial process, Shane (2003) has identified a few of the common strategies entrepreneurs use to mitigate some of the consequences of these issues. In particular these are: growth from a small scale; entry via acquisition; focus strategy; flexibility and adaptability; forming alliances; and legitimization. Each of these strategies will be discussed further below.

Growth from small scale

As was discussed in the resource acquisition section, entrepreneurs usually must exploit opportunities in the face of limited access to resources and financial capital. Furthermore, the

pursuit of an opportunity requires the entrepreneur to bear a significant amount of risk. These factors will prevent most entrepreneurs from establishing new ventures on the same scale as large established firms (Shane, 2003). Entrepreneurs can also minimize potential downside losses from incorrect assumptions about the market by entering into small niches at a small size (Bhide, 2000). If their conjectures are correct, however, and their capabilities and the market demand are both adequate, then they can increase their investment using a similar logic as investing in real options (Caves, 1998).

Entry via acquisition

By acquiring an already existing business to adapt to one's perceived market opportunity, an entrepreneur can mitigate a substantial amount of the uncertainty inherent in the entrepreneurial process (Shane, 2003). Existing business can provide information about market demand, production processes and competitive abilities of a venture capable of exploiting the entrepreneurial opportunity (Bates, 1990). Though, it would appear that this would be more appropriate for a line item extension or Kirznerian opportunity rather than a Schumpeterian one.

Focus Strategy

Focusing on a single product or service and a single market segment can also assist in mitigating the information asymmetry and uncertainty issues as well (Shane, 2003). This strategy is beneficial for two primary reasons. The first is that in order to resolve the uncertainty about the entrepreneur's conjecture, she must gather information about the opportunity and the appropriate resources to exploit it. This process involves the expenditure

of capital, which is very costly for new ventures (Anton and Yao, 1995) as they must pay market premiums for financial capital, instead of using internal capital (Shane, 2003). By adopting a focus strategy, they only need to source financial capital externally for the first venture, and can use the cash flows that venture produces to exploit further opportunities (Shane, 2003). The second benefit of a focus strategy is that pursuing an underserved market niche is more likely to be profitable for an entrepreneur with limited resources than going head to head with a large established firm (Shane, 2003).

Flexibility and Adaptability

Given the aforementioned elements of uncertainty in any entrepreneurial opportunity, there will always remain the possibility that some unforeseen event will cause the initial opportunity to no longer exist. Furthermore, entrepreneurs cannot predict the future and cannot plan for all contingencies in their business planning (Shane, 2003). Therefore, new ventures must have the ability to adapt their strategies and to innovate new solutions to unanticipated problems in order to be successful (Bhide, 2000).

Forming Alliances

Shane (2003) states that forming alliances with established firms can provide many benefits to entrepreneurs in the process of exploiting their opportunity. The first is that opportunities often have short lifespans and if the entrepreneur were to attempt to create all of the assets needed to exploit it herself, she may miss the window of opportunity (Katilla and Mang, 2003). Second, by obtaining control of resources without having to vertically integrate the entire production process, the entrepreneur can save large amounts of capital (Larson, 1992)

and shift some of the downside risk onto others (Venkataraman, 1997). And third, as Shane (2003) puts it, “The entrepreneur faces a fundamental problem in convincing others that the product or service she has developed to exploit an opportunity is valuable. The fact that potential customers have not identified the opportunity makes them disciplined to believe that it is not valuable.” This problem can be mitigated by allying with an established firm through a formal alliance, licensing agreement or marketing agreement to sell the entrepreneur’s product under the established firm’s brand name (Eisenhardt and Schoonhoven, 1996).

Legitimation

Due to the information asymmetry inherent in the entrepreneurial process, resource holders may doubt the opportunity and the entrepreneur’s method for exploiting it (Shane, 2003). To overcome this problem, entrepreneurs need to engage in strategic actions that signal the opportunity and their exploitation method are socially acceptable (Aldrich and Baker, 2001). This process, called legitimation, can involve adhering to collective agreements on standards and designs (Shane, 2003) or the procedures that reputable authorities use for certification (Rao, 1994). Doing so will reduce stakeholder confusion and doubt and make them more likely to engage with the entrepreneur in the appropriate manner (Shane, 2003).

I. The Organizing Process

After the decision to exploit the opportunity has been made, but before the launch of the new venture, an entrepreneur must engage in the organizing process. This process, occurs over time, and involves such activities as obtaining equipment, establishing production processes, hiring employees and setting up the legal entity for the venture (Katz and Gartner,

1988). The time spent doing this will vary from venture to venture, but on average will take about a year (Reynolds and White, 1997). Most entrepreneurs will engage in this process by basing their routines and structures on what they have learned from their education, previous work experience and example set by other firms (Aldrich and Von Glinow, 1992; Katz *et al.*, 2000; Klepper, 2001).

i The Role of Planning

Engaging in business planning can be very beneficial in the organizing process as most entrepreneurial efforts to exploit new opportunities are based on unsubstantiated ideas and conjectures (Shane, 2003). Planning can test the internal consistency, plausibility and accuracy of the entrepreneurs ideas about the production process, business governance and product demand by forcing the entrepreneur to clearly articulate her assumptions and beliefs (Harper, 1996). It can also indicate the human, physical and financial resources needed before the acquisition of those resources leading to a reduction in costs occurred from trial and error (Shane, 2003). Planning helps the entrepreneur to determine what information she still needs to obtain (Duchesneau and Gartner, 1990), helps her to clarify and facilitate the achievement of her goals and objectives (Locke and Latham, 1990; Rousseau, 1997) and ultimately allows her to convey her conjectures and beliefs about the opportunity to others in a systematic and easy to understand fashion (Shane, 2003).

ii The Modes of Exploitation

During the organizing process, the entrepreneur must also decide what mode of exploitation she wishes to use to pursue the opportunity. In general, Shane (2003) says this choice is guided by two fundamental questions:

- 1) Does the individual who identified the opportunity want to exploit it on behalf of someone else or does he want to exploit it on his own (i.e. as a spin-off)?
- 2) Does the individual want to use a market mechanism, such as licensing or franchising, exploit the opportunity or does he want to use a hierarchical mechanism, such as a firm?

The answer to these questions will depend on a number of factors. In general, however, entrepreneurs will tend to spin-off when the expected utility from founding a firm for the entrepreneur is larger than the expected utility from exploiting on behalf of her current employer (Audretsch, 2001). This is especially true if the entrepreneur feels the employer is failing to capitalize on the opportunity properly (Klepper and Sleeper, 2001) or not at all. If the opportunity is based on radical technology or ideas that undermine a firm's competitive advantage as firms tend to avoid investing in opportunities that cannibalize their existing operations (Arrow, 1962). Furthermore, established firms are often structured to search for and refine familiar information that improves operations as opposed to identifying and developing radically different opportunities (Henderson, 1993; Henderson and Clark, 1990; Nelson and Winter, 1982). Firms will also institute incentives for employees to focus on the status quo of serving their existing customer with incremental improvements (Christiansen and Bower, 1996) instead of on innovation (Foster, 1986; Holmstrom, 1989). While finally, if a firm has a strong

brand name reputation, they may be more reluctant to try something new and different that could damage the brand (Holmstrom, 1989).

In regards to whether an entrepreneur will use a market mechanism or a hierarchical firm to exploit the opportunity, most new ventures will use the hierarchical mode of exploitation to exploit the opportunity (Shane, 2003). However, there are four key factors will influence this decision to use a market mechanism, such as franchising or licensing, instead: cost, speed, capabilities and information (Venkataraman, 1997). If the new venture is costly, and the entrepreneur has limited capital finances, then it is likely they will use market mechanisms to exploit the opportunity (Martin, 1988; Shane, 1998). Market mechanisms are also likely to be used if the opportunity is time-dependent or short-lived as organizing a firm to exploit the opportunity may be too slow (Venkataraman, 1997), or if the discoverer of the opportunity does not have a comparative advantage in exploiting it and can gain from selling it to someone who does (Teece, 1980). Lastly, if the underlying information key to the opportunity can be protected against appropriation, such as with a patent, if the information can be easily codified, or if there is a high risk of adverse selection and moral hazard in the use of hierarchical mechanisms, then a market mechanism will be preferred as well (Shane, 2003).

iii Establishing a Legal Entity

Establishing a legal entity is key to legitimizing the new venture, establishing property rights and facilitating organizing activities (Shane, 2003). There are three types of legal entities that new ventures can form: a sole proprietorship (which is the default form), a partnership and a corporation. A sole proprietorship is a venture where an individual engages in all the entrepreneurial activity and uses the profits as a source of income for tax purposes. A

partnership is an agreement between two or more people to work together and share the residual claims. And a corporation or LLC is a legal entity that exploits the opportunity but has a limited liability consisting of only the amount invested in the corporation (Shane, 2003). By limiting the entrepreneur's liability she is exposed to less downside risk, and hence can be more entrepreneurial in her actions (Shane, 2003). Significant research shows that adopting a corporate legal form enhances new venture performance (e.g. Wicker and King, 1989; Kalleberg and Leight, 1991; Cressy, 1996b).

iv Determining Venture Size

Another key decision facing the entrepreneur in the organizing process is how large the wish the venture to be. Given that much of the information necessary for the successful execution of a new venture cannot be known at the time the organizing process is first initiated, having a larger team with more employees can help to gather and assimilate the required information more quickly (Shane, 2003). In addition, larger teams are more likely to have complementary knowledge and skill sets useful in pursuing the opportunity (Klepper, 2001; Roberts, 1991a; Roure and Maidique, 1986). Teams of people with different beliefs can also act to verify and provide validity to the venture idea as well as combine people who have prior relationships and trusts built up (Cooper and Daily, 1998). In addition to choosing an appropriate management team, it is as equally important to choose the correct number of employees for the venture (Shane, 2003). Having more employees allows the organization to utilize a large knowledge pool and acquire more information faster (Shane, 2003) but has to be traded off with the cost each employee requires.

The Use of Social Ties in the Selection of Employees

When selecting appropriate employees, any organization has to be concerned with the implicit adverse selection and moral hazard issues that are present due to the information asymmetry present in the recruiting process (Shane, 2003). This problem, however, is all the more difficult for an entrepreneur founding a new venture due to the new venture's associated uncertainty. Not only must an entrepreneur worry about whether the employee has an appropriate skill set (adverse selection) and work ethic (moral hazard) but also what that skill

set should be. Given this, many entrepreneurs will hire people they have direct or indirect ties with to mitigate some of these problems in early recruiting efforts (Aldrich, 1999; Francis and Sandberg, 2000). This familiarity helps to minimize the adverse selection and moral hazard issues associated with determining competencies (Nohria, 1992) as well as recruiting and retention costs (Jovanovic, 1984). Social ties will also reduce the tendency for either party to engage in opportunistic behavior (Williamson, 1985) as the associated cost for doing so is greater when a social tie is present. Finally, given the newness of the venture, many of the organizational rules will often be implicit and in a state of flux, which can be difficult to convey to strangers who may not agree on the same implicit rules and norms (Aldrich, 1999).

v Creation of the Organization Structure and Production Process

Lastly, the entrepreneur will also need to establish the production process to transform the resources into the new product or service, market the output and establish the organizational structure of the venture (Schumpeter, 1934; Nelson and Winter, 1982). This will also involve conforming to any industry and legal regulations, societal norms and tax codes. Once this is all accomplished the venture is ready to launch and the market will determine its performance.

Appendix B

Exhibit A: Interview guide used with clients

Client's name _____

Business name _____

1. To begin with, please describe the business idea that the product center helped you out with.
2. What was your inspiration for this idea?
3. What motivated your decision to turn this idea into a new venture?
4. How long were you working on that idea before you decided to launch?
5. In what ways did the Product Center help out with the success of your business?
6. What factors do you think will give you an advantage over your competition?
7. How did you hear about the Product Center?
8. How often did you meet with the Product Center Counselor?
9. Did you write a business plan with the Product Center?
10. Have you ever written a business plan before?
11. How helpful was the business plan you wrote in obtaining financing from lenders?
 - a. Did you have any difficulties at all going through the Product Center's process?
 - b. On a scale of one to five where 1 is not very helpful and 5 is very helpful please answer the following questions:
 - i. How helpful was the Product Center in launching your new venture?
 - ii. How helpful was The Product Center in dealing with a specific question you had trouble with?
 - iii. How helpful was the Product Center in providing information on a broad range of topics?
 - iv. How helpful was the Product Center in your decision to launch the new venture?
 - v. How quickly and effectively did the P.C. help you to achieve your goals?
 - vi. What services did you use? (Not answered with the scale) How helpful was that service (according to the scale)?
12. Do you have previous experience in managing a business?
13. Were there any services you received that you felt the Product Center could improve upon?
14. Were there any services not offered by the Product Center that you wish were?
15. Did you have to pay a fee for any services?
16. The P.C. historically has provided a lot of services for free; their budget situation now forces them to charge a fee for their work, which of the services that you received would you have been willing to pay for?
17. Which, if you had to pay for them, would you have not chosen to use?

18. Would you recommend the Product Center to a friend who wished to start up a business?
19. If you have any future business ideas you want to pursue, will you go back to the Product Center?

Exhibit B: Interview guide for Product Center core staff members:

1. In your experience, do entrepreneurs come to you first with an innovative idea they have or a potential opportunity in the market they have discovered?
2. How often do you get entrepreneurs without an idea or opportunity coming to see if the Product Center has a good one somebody else has decided not to pursue?
3. What are the biggest obstacles people have in creating the venture concept?
4. How can you tell when the venture concept is ready to begin testing for potential?
5. Can you explain in further detail the steps and resources used in the testing for potential stage?
6. What obstacles do entrepreneurs typically face in this stage?
7. How can you tell when the venture concept is ready to begin testing for feasibility?
8. Can you explain in further detail the steps and resources used in the testing for feasibility stage?
9. What obstacles do entrepreneurs typically face in this stage?
10. How can you tell when the venture concept is ready to launch?
11. Can you explain in further detail the steps and resources used in helping entrepreneurs to launch their new venture?
12. What obstacles do entrepreneurs typically face in this stage?
13. If you were to make a rough estimate at what percentage of clients first come to the PC at each of the concept formation, testing for potential, testing for feasibility and preparing for launch stages, what would that estimate be?

Exhibit C: Concept Definition Worksheet

MSU PRODUCT CENTER FOR AGRICULTURE AND NATURAL RESOURCES

BUSINESS OR PRODUCT CONCEPT DEFINITION

Instructions:

A common term in business development is “elevator pitch.” An elevator pitch is the message you can deliver about your idea in the one minute it takes an elevator to travel from the first floor of a bank to top floor. The term was created when an entrepreneur visited a bank to sell his idea to a banker. Unknown to him, he ended up riding the elevator with the banker who had to decide the fate of his idea. He had a clear, concise message that he told his elevator partner in the ride up and sold the banker on his idea in that elevator ride! The **Business or Concept Definition** is the start of your elevator pitch. Keep it concise but give us what we need to know to evaluate your idea.

When you fill out the **Business or Concept Definition**, complete all the sections to the best of your ability. Work with your Counselor to create an accurate draft. The more complete your answers, the easier it will be to determine when and how quickly you can move on to other services for the development process.

Your Counselor will work with the staff at the Product Center to review your **Business or Concept Definition** in detail and provide feedback to you about areas where you need to focus to move through the development process.

Each question of the **Business or Concept Definition** has an example of the type of information we are looking for. Keep in mind that you will likely know much more about your idea than the Product Center staff. Therefore do not assume that you do not have to provide a basic description of your product, service or business; and that we will understand the processes you will use to create your product or service.

1. Briefly describe your business or product idea.

Example: I am going to produce flour made from Spelt grain that I produce on my farm in a mill that already exists. The mill (Michigan Specialty Flours, Inc.) is owned by my neighbor and she has agreed that she will mill the Spelt for me. The flour will be packaged in 1 pound bags. Currently I produce the flour in a table top mill in my kitchen. I am going to do this because my son has suffered from Celiac's Disease and Spelt flour helps him feel better. People in my Celiacs' support group have had similar results from the flour I have given them that I produce at home.

a. What is your income goal from this business or product?

Example: I currently take home about \$25,000 from my job off the farm. I will need to replace that income in our family budget.

b. How much time do you plan to spend on this project?

Example: Initially I will be able to devote about 10 hours a week to this project. In about 3 months I will be moving to part time on my off farm job and should then have about 30 hours a week available for this project.

2. Who is the target customer? (If possible, name specific potential customers.)

Example: My target customers are the 12 million people in the US who cannot tolerate flour made from grain with gluten. Specifically I have contacted The Gluten Free Mall, an internet based marketing and sales venture for gluten free products. They are willing to add Spelt flour to their line of flours and say I will need to come in at a price of about \$3.00 per pound. I have also contacted Foods for Living in Okemos and they have expressed an interest in adding the product to their existing flour line. They currently pay \$48 for a case of 24-1 pound packages of gluten free soybean flour and \$84 for a case of 24-14 ounce chestnut flour.

3. What benefits would the target customer want from your business or product?

Example: My target customers struggle to find flour that is gluten free that has the flavor and texture to produce good pastries and cookies. The cheapest flour is made from rice but is very bland. Chestnut flour has good texture and flavor but is very expensive. Flour made from Spelt provides good flavor and texture at a price between rice and chestnut flour.

4. Characteristics of the Market for Your Business or Product

a. What performance characteristics will the customer demand from your business or product?

Example: They will expect a white to off-white flour that can be used to produce pastries and cookies. It will need to perform similar to wheat flour in the recipe preparation and baking process. It must produce a moist, good tasting finished product.

b. How will you market the business or product to the customer?

Example: I will wholesale my flour to retailers who are in the specialty foods business. I will participate in specialty foods shows in Chicago and St. Louis that attract a large number of health food retailers. I will create a brochure that shows the buyers for these companies the unique characteristics of my flour made from Spelt, a description of my business to assure them that I will be a reliable supplier of the product, and an insert that presents my pricing information. I will provide quantity discounts for customers who can receive at least 1,000 pound in one shipment. I will also offer the retailers point of sale materials that include shelf talkers and recipe cards. For my internet retailers, I will provide electronic graphics of my packages, electronic recipes for inclusion on their web sites, and offer links to my website that includes recipes, general information about Celiac's disease and hints about how consumers can use my flour to improve the quality of their life.

c. How much more will the customer be willing to pay for your performance characteristics over existing businesses or products in the marketplace?

Example: Consumers should be willing to pay about \$6.00 per pound which means my wholesale price will need to be about \$3.00 per pound. This is about \$3.00 per pound higher (at retail) than the cheapest gluten free flour (bean flour) but about \$4.00 per pound below the highest retail priced flour that is made from chestnuts.

Why?

Example: The retail price of bean flour is about \$2.75 per pound, rice flour about \$3.00, sorghum flour about \$5.00 and chestnut flour about \$10.00. The largest volume of sales in this category is rice flour and the smallest is chestnut flour. According to my research with current retailers, their customers will be willing to pay a price somewhere between that of sorghum flour and chestnut flour because flour made from Spelt creates baked products with more flavor and texture that is comparable to chestnut flour but at a more reasonable cost to the consumer.

d. Who will be your key business or product competitors?

Example: My key direct competitors will be producers of rice flour and bean flour. Direct competitors will also include millers who offer a broad range of gluten free products. My indirect competitors will be bakeries such as Back to Basics and The Bread Baker Company that sell bread, cookies and pastries made from gluten free flours.

e. How will you compete against these competitors?

Example: I will not compete with all these entities. Consumers who are only interested in the cheapest product and do not care about the quality of the baked products will not be interested in my Spelt flour. I will work with my retail customers to identify the consumers who enjoy baking quality products and develop promotional materials and information to target this segment of the customer base. One of the attributes of my product is that serious home bakers can create products with a "mouth feel" amazingly similar to equivalent products containing wheat or gluten.

5. Describe the production process that will be used in the business or for the product.

Example: I will contract with the owner of an existing mill to produce my flour. That mill is certified organic and only mills gluten free products. It currently produces flour from soybeans, garbanzo beans and soybeans. The mill also has a packaging line for one-pound packages of flour.

a. Is the production process in anyway unique (a simple yes or no is sufficient for initial definition; elaborate on specifics for final definition)?

Example: The process of producing and packaging my flour is not unique. The unique attributes of my product is that the flour produces baked products that are very similar in mouth feel and flavor to wheat flour and other gluten flours.

6. Describe the distribution process that will deliver your product to the customer.

Example: Michigan Specialty Flours, Inc., the mill that will produce my flour, has a distribution system established to health food specialty retailers in the Great Lakes area. I will contract with her to distribute my flour. Eventually I plan to market some of my products directly to consumers via the internet but my focus for the immediate future is the wholesale distribution channel.

7. What do you see as the risks or limitations to success for your business or product?

Example:

- *Lack of marketing expertise*
- *Insufficient capital to create the promo materials*
- *Not being able to produce enough Spelt on my farm to meet my production needs*
- *Competitors taking significant price cuts to keep me out of the marketplace*

8. How do you plan to finance this business or product?

Example: I have personal savings and can obtain a mortgage on our farm to pay for the initial processing by Michigan Specialty Flours, Inc. My husband's family has agreed to loan me a portion of the money I need to develop the promotional materials. Those sources should provide me with enough for the initial cash flow needs. I am working with Greenstone Farm Credit Services on a financing plan once I have produced an inventory of product and have proven that I can sell the product.

a. How much will you have to produce to break even (break even analysis)?

Example: It costs me about \$2.25 per pound to produce, package and ship the flour. I expect to sell it at \$3.00 per pound. It will cost me \$1,000 a month to rent the mill, pay for electricity and insurance. Using the formula that break even = fixed costs / (unit selling price – variable costs), my break even volume is 1,333 pounds per month. [$\$1,000 / (\$3.00 - \$2.25) = 1,333$ pounds]

9. Describe your human resources plan. Who will manage your business? Do you plan to hire additional personnel?

Example: I plan to manage the business myself. Production will be contracted with Michigan Specialty Flours, Inc. That company will hire and manage production workers. They expect to add two full time employees as the result of milling my Spelt grain. Likewise distribution will be contracted with Michigan Specialty Flours, Inc. They do not plan to add any additional personnel as they have excess trucking capacity. I plan to hire two field sales representatives after a few months of sales. These individuals will be responsible for visiting stores, erecting in-store displays, meeting with the store managers and buyers to assure that my promotion and marketing programs are effectively reaching the target audience.

10. Describe your business or product development experience. (Attach a resume if that would be helpful.)

Example: I have operated a retail farm market based on our family farm. In that capacity I have learned to work with consumers and have directed five employees. I maintain the records for our family farm using the Tel Farm record keeping system. This includes maintaining labor records.

11. What services are you requesting of the Product Center? (Check all that apply.)

(We will do our best to assist you in any fashion needed. In addition to the broad array of services that we offer, we have an extensive network of business contacts to which we can refer you if we cannot provide a particular service directly.)

☐	Product development (how to increase your recipe from a kitchen to batch production, etc.)		
☐	Business planning (statement of your mission/objectives, business organization, marketing plan, management/human resources plan, financing plan)		
☐	Strategic planning	Strategic planning answers the question, "Are you doing the right things in your business?" while operational planning answers the questions, "Are you doing things right?"	
☐	Operation/production planning		
☐	Financial planning (developing income, cash flow, net worth statements)		
☐	Organizational/legal planning (type of business, contracts, etc.)		
☐	Feasibility study (will your idea work if everything does not go right?)		
☐	Regulatory requirements (zoning, labeling laws, licensing, etc.)		
☐	Market research (who will pay you for your idea?)		
☐	Resource assessment (assessing the money, time, people and technology to achieve your goals)		
☐	Human resource planning (organizational chart, employee training, worker safety, compliance, etc.)		
☐	Marketing planning (how will you make your potential customers aware of your business, product or service?)		
☐	Product testing (will consumers accept your product or service?)		
☐	Product packaging (what type of package should you use?, what is the most effective package for your product?)		
☐	Label design (labeling to attract customers that meets regulatory requirements)		
☐	Nutritional labeling (develop nutritional information for your food product)		
☐	Other (please specify)		

Briefly describe why you need these services:

Example: I checked business planning because Greenstone FCS says I will need a business plan before they will lend me money. I checked organizational planning because Michigan Specialty Flour has indicated an interest in being part owner. I need to investigate this option to assure I make the right decision. I checked human resources planning because I need to develop several policies for directing my sales reps. I checked marketing planning because I need help designing the promotional materials I want to offer my customers. I checked label design because I want to develop an attractive label that will appeal to the consumer segment that will be interested in purchasing my flour. I checked nutritional labeling because I want to include nutritional information on my package.

Counselor Statement:

Counselor's name: _____

I worked with (client name) _____ to develop the preceding **Business or Concept Definition**. In my opinion, it fairly represents the idea of the client in preparation for further business or product development services from the MSU Product Center.

Counselor Signature _____ Date _____

Client Signature _____ Date _____

Exhibit D: Product Center Starting A New Food Business worksheet

Step #1 – Develop your business idea into a Concept.

- ___ Define the concept using the Concept Definition tool
- ___ Discuss and review the tool with Product Center Staff
- ___ Together identify areas which should be explored further
- ___ Create a Plan of Work with actionable items

Step # 2 – Develop a Plan of Work

Part I – Business Planning

___ Identify the business directions which are possible and select those which will be researched further for business direction

___ What business plan tool will best meet your need to further justify the concept?

___ Begin working on Business Plan sections relating to the business directions identified.

- Executive Summary
- Mission Statement, History and Objectives
- Background Information
- Organizational Matters
- Marketing Plan
- Financial Plan

Part II – Product Development

___ Identify the **regulatory agencies** which will be required for legal sale of product. Learn of the requirements. **Who? FDA or USDA and MDA**

___ Determine the **food safety parameters** of the product to ensure safe and wholesome distribution and sale of product. **Test? pH, Process (Schedule) Authority**

___ Identity the **proper packaging** for maximum product shelf-life, cost, marketability and customer convenience. **What? Material/Function**

___ Develop the **product label** for identification, nutritional information and retail sales/warehousing. **Guidelines? MDA/FDA/USDA**

___ Determine the **entity** which will **manufacture** the product. **?Self or Co-packer**

___ Finalize **formula (recipe) for commercial production**, according to

manufacturer. ***Ingredient additions for quality (shelf life) or food safety***

Part III – Product Launch

_____ Determine volume production for product introduction. ***Units per case***

_____ Prepare for product introduction meetings and develop sales packet.

_____ Develop target customer sales list, schedule meetings
Target buyers (retail/food service) or food “events”

_____ Service the customer account to maintain product sales

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REFERENCES

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