

**SIXTH EDITION**

# New Venture Creation

ENTREPRENEURSHIP FOR THE 21ST CENTURY

**Jeffrey A. Timmons, A.B., M.B.A., D.B.A.**  
**Franklin W. Olin Distinguished Professor of Entrepreneurship**

Director, Price Babson College Fellows Program

Babson College

Babson Park, Massachusetts

and

**Stephen Spinelli, Jr., B.A., M.B.A., Ph.D.**  
**John H. Muller, Jr. Chair, Entrepreneurship**

Director, Arthur M. Blank Center for Entrepreneurship

Chairman, Entrepreneurship Division

Babson College

Babson Park, Massachusetts



Boston Burr Ridge, IL Dubuque, IA Madison, WI New York San Francisco St. Louis  
Bangkok Bogota Caracas Kuala Lumpur Lisbon London Madrid Mexico City  
Milan Montreal New Delhi Santiago Seoul Singapore Sydney Taipei Toronto

## PART I

### The Opportunity

#### The Entrepreneurial Revolution 3

The Entrepreneurial Revolution 3

The Entrepreneurial Generation  
and the Death of Brontosaurus  
Capitalism 4

Entrepreneurship: America's Secret  
Weapon 4

Entrepreneurship: A New Centerpiece  
in American Public Policy  
Debate 4

The Entrepreneurial Revolution: A Decade  
of Acceleration and Boom 14

The Global Economic Weapon 15

America's Self-Made Millionaires 16

Dawn of the New Age of Equity  
Creation 16

Building an Entrepreneurial  
Society 17

Chapter Summary 19

Study Questions 19

Mind Stretchers 20

Exercise

*Visit with an Entrepreneur and Create  
a Lifelong Learning Log* 21

**Case:** *PC-Build, Inc.* 23

#### 2 The Entrepreneurial Process 47

Demystifying Entrepreneurship 47

Classic Entrepreneurship: The Startup 48

Entrepreneurship in Post-Brontosaurus  
Capitalism: Beyond Startups 48

"People Don't Want to Be Managed.  
They Want to Be Led" 48

Signs of Hope in a Corporate  
Ice Age 49

Metaphors 49

Entrepreneurship = Paradoxes 50

The Higher Potential Venture: Think Big  
Enough 51

Smaller Means Higher Failure Odds 52

Getting the Odds in Your Favor 53

Threshold Concept 54

Promise of Growth 54

Venture Capital Backing 54

Private Investors Join Venture

Capitalists 55

Find Financial Backers and Associates  
Who Add Value 55

Option: The Lifestyle Venture 55

The Timmons Model: Where Theory and  
Practice Collide in the Real World 56

Intellectual and Practical Collisions  
with the Real World 56

Value Creation: The Driving  
Forces 56

Change the Odds: Fix It, Shape It,  
Mold It, Make It 56

Recent Research Supports  
the Model 63

<p>Entrepreneurial Reasoning: The Entrepreneurial Mind in Action 63</p> <p style="padding-left: 20px;">Apprenticeship: Acquiring the 50,000 Chunks 65</p> <p style="padding-left: 20px;">Role Models 66</p> <p>Myths and Realities 66</p> <p>What Can Be Learned? 66</p> <p>A Word of Caution: What SATs, IQ Tests, GMATs, and Others Don't Measure 69</p> <p>Chapter Summary 70</p> <p>Study Questions 70</p> <p>Mind Stretchers 71</p> <p><b>Case:</b> <i>James Kenefic: The Making of an Entrepreneur</i> 72</p>	<p>Screening Criteria: The Characteristics of High Potential Ventures 91</p> <p>Gathering Information 100</p> <p style="padding-left: 20px;">Finding Ideas 100</p> <p style="padding-left: 20px;">Published Sources 103</p> <p style="padding-left: 20px;">Other Intelligence 104</p> <p>Chapter Summary 104</p> <p>Study Questions 105</p> <p>Mind Stretchers 105</p> <p><i>Case: Roxanne Quimby</i> 106</p> <p>Exercises 113</p>
<p><b>3 The Opportunity: Creating, Shaping, Recognizing, Seizing 79</b></p> <p>Think Big Enough 79</p> <p>Opportunity through a Zoom Lens 80</p> <p style="padding-left: 20px;">Transforming Caterpillars into Butterflies 80</p> <p style="padding-left: 20px;">New Venture Realities 80</p> <p style="padding-left: 20px;">The Circle of Ecstasy and the Food Chain for Ventures 81</p> <p style="padding-left: 20px;">When Is an Idea an Opportunity? 82</p> <p style="padding-left: 20px;">The Real World 82</p> <p style="padding-left: 20px;">Spawners and Drivers of Opportunities 82</p> <p style="padding-left: 20px;">Search for Sea Changes 84</p> <p style="padding-left: 20px;">Desirable Business/Revenue Model Metrics 84</p> <p>The Role of Ideas 84</p> <p style="padding-left: 20px;">Ideas as Tools 84</p> <p style="padding-left: 20px;">The Great Mousetrap Fallacy 85</p> <p style="padding-left: 20px;">Contributors to the Fallacy 86</p> <p>Pattern Recognition 86</p> <p style="padding-left: 20px;">The Experience Factor 86</p> <p style="padding-left: 20px;">Enhancing Creative Thinking 87</p> <p style="padding-left: 20px;">Approaches to Unleashing Creativity 87</p> <p style="padding-left: 20px;">Team Creativity 87</p> <p style="padding-left: 20px;">Big Opportunities with Little Capital 88</p> <p style="padding-left: 20px;">Real Time 89</p> <p style="padding-left: 20px;">Relation to the Framework of Analysis 90</p> <p>Screening Opportunities 91</p> <p style="padding-left: 20px;">Opportunity Focus 91</p>	<p><b>4 Screening Venture Opportunities 119</b></p> <p>Screening Venture Opportunities 119</p> <p style="padding-left: 20px;">Four Anchors 119</p> <p style="padding-left: 20px;">QuickScreen 120</p> <p style="padding-left: 40px;"><i>Venture Opportunity Screening Exercises (VOSE)</i> 120</p> <p>Exercise QuickScreen 121</p> <p>Venture Opportunity Screening Exercises 122</p> <p style="padding-left: 20px;">Exercise 1 <i>Opportunity Concept and Strategy Statement</i> 123</p> <p style="padding-left: 20px;">Exercise 2 <i>The Venture Opportunity Profile</i> 124</p> <p style="padding-left: 20px;">Exercise 3 <i>Opportunity Shaping Research and Exercise</i> 128</p> <p style="padding-left: 20px;">Exercise 4 <i>Customer Contact Research and Exercise</i> 134</p> <p style="padding-left: 20px;">Exercise 5 <i>Mining the Value Chain—Defining the "White Space"</i> 137</p> <p style="padding-left: 20px;">Exercise 6 <i>Economics of the Business—How Do You Make Money in the White Space</i> 141</p> <p style="padding-left: 20px;">Exercise 7 <i>Capital and Harvest—How Will You Realize Dollars from the Venture</i> 148</p> <p style="padding-left: 20px;">Exercise 8 <i>Competitive Landscape—Your Strategic Analysis</i> 150</p> <p style="padding-left: 20px;">Exercise 9 <i>Founder's Commitment</i> 159</p> <p style="padding-left: 20px;">Exercise 10 <i>Flaws, Assumptions, and Downside Consequences—Risk Reconsidered</i> 161</p> <p style="padding-left: 20px;">Exercise 11 <i>Action Steps—Setting a Wee/c-by-Week Schedule</i> 163</p> <p style="padding-left: 20px;">Exercise 12 <i>Four Anchors Revisited</i> 165</p> <p><b>Case:</b> <i>Gary and George Mueller</i> 166</p>

<b>5</b>	<b>Entrepreneurs and the Continuing Internet Revolution: The Expanding Frontier 183</b> The Continuing Internet Revolution: The Expanding Frontier 183 Internet Overview 184 Origins of the Internet 186 A Quick Overview of Internet Basics 187 WebSites 187 Usenet 187 Mailing Lists 188 Search Engines 188 The Dot.com Experience 188 The Internet Business Environment and Business Models 189 Internet Business Environment 189 Internet Business Models 190 How an Existing Business Can Benefit from the Internet 191 Customer Service/Support 192 Technical Support 194 Data Retrieval 194 Public Relations and Investor Relations 195 Selling Products and Services 195 An Example: The Internet Fashion Mall 195 Factors to Consider in Designing Your Commercial Web Site 195 Security and Payment Issues 196 Cutting Costs 196 Obtaining Advice/Information 197 Internet-Related Opportunities for the Creation of New Businesses 198		Chapter Summary 199 Study Questions 199 Mind Stretchers 199 Case: <i>Securities Online, Inc.</i> 200 Appendix A Excerpts from the Securities Online Business Plan 203
<b>6</b>	<b>Franchising 221</b> Introduction 221 Job Creation versus Wealth Creation 222 Franchising: A History of Entrepreneurship 222 Franchising: Assembling the Opportunity 223 Primary Target Audience 223 Evaluating a Franchise: Initial Due Diligence 225 Franchisor as the High Potential Venture 226 Key Components of a Franchise Offering 227 Service Delivery System 227 Training 228 Field Support 228 Marketing, Advertising, and Promotion 229 Product Purchase Provision 230 Franchise Relationship Model 230 Chapter Summary 232 Study Questions 232 Mind Stretcher 232 Case: <i>Mike Bellobuono</i> 233		

**PART II**

**The Founders**

<b>7</b>	<b>Entrepreneurial Mind in Thought and Action 245</b> The Search for Understanding 245 Three Principles for Achieving Entrepreneurial Greatness 245 Leadership and Human Behavior 246 Research 247 Converging on the Entrepreneurial Mind 249 Desirable and Acquirable Attitudes and Behaviors 249		Six Dominant Themes 249 Other Desirable (But Not So Acquirable) Attitudes and Behaviors 255 Demographic Shifts in the Entrepreneurial Landscape 256 The Impact of Gender 256 Race, Ethnicity, and Culture 257 A New Generation of Business Owners 258 Toward Inclusion of Diverse Groups in Entrepreneurship 258
----------	--	--	--

A Look at the Nonentrepreneurial Mind 258	Anchoring Vision in Team Philosophy - and Attitudes 304
The Concept of Apprenticeship 259	A Process of Evolution 306
Shaping and Managing an Apprenticeship 259	Filling the Gaps 306
Windows of Apprenticeship 260	Additional Considerations 308
A Personal Strategy 261	Common Pitfalls 309
Entrepreneur's Creed 262	Rewards and Incentives 310
Chapter Summary 262	Slicing the Founder's Pie 310
Study Questions 262	The Reward System 311
Mind Stretchers 263	Critical Issues 311
Exercise <i>QuickLook: The Personal Entrepreneurial Strategy 26 A</i>	Considerations of Timing 312
<b>Case: Michael Healey (A) 265</b>	Considerations of Value 312
<b>8 The Entrepreneurial Manager 273</b>	Compensation and Incentives in High Potential Ventures 313
The Entrepreneurial Domain 273	Chapter Summary 313
Converging on the Entrepreneurial Manager 273	Study Questions 313
Principle Forces and Venture Models 274	Mind Stretchers 313
Stages of Growth 276	<b>Case: Michigan Lighting, Inc. 314</b>
A Theoretical View 276	Exercise <i>Rewards</i> 322
Managing for Rapid Growth 277	<b>10 Personal Ethics and the Entrepreneur 327</b>
What Entrepreneurial Managers Need to Know 280	Exercise <i>Ethics</i> 327
Management Competencies 281	Overview of Ethics 332
Skills in Building Entrepreneurial Culture 281	Ethical Stereotypes 333
Other Management Competencies 283	Should Ethics Be Taught? 334
Chapter Summary 285	Ethics Can and Should Be Taught 334
Study Questions 285	The Usefulness of Academic Ethics 335
Mind Stretchers 286	Integrity as Governing Ethic 335
Exercise <i>Managerial Skills and Know-how Assessment</i> 287	Entrepreneurs' Perspectives 336
<b>Case: Burt's Bees 297</b>	Thorny Issues for Entrepreneurs 337
<b>9 The New Venture Team 303</b>	Action under Pressure 338
The Importance of the Team 303	Different Views 338
The Connection to Success 303	Problems of Law 339
Forming and Building Teams 304	Examples of the Ends-and-Means Issue 339
	An Example of Integrity 340
	Ethics Exercise Revisited 340
	Chapter Summary 340
	Study Questions 341
	Mind Stretchers 341
	<b>Case: Wayne Post oak 342</b>

**PART III**

**Resource Requirements**

<b>11 Resource Requirements 347</b>	Bootstrapping Strategies: Marshaling and Minimizing Resources 348
The Entrepreneurial Approach to Resources 347	Build Your Brain Trust 349

Using Other People's Resources (OPR) 349

Outside People Resources 350

    Board of Directors 350

    Alternatives to a Formal Board 352

    Attorneys 353

    Bankers and Other Lenders 355

    Accountants 356

    Consultants 357

Financial Resources 358

    Analyzing Financial Requirements 358

General Resource Information 364

Chapter Summary 364

Study Questions 364

Mind Stretchers 365

Exercise *Build Your Brain Trust* 366

Exercise *How Entrepreneurs Turn Less into More* 367

**Case:** *FAX International, Inc.* 368

**12 The Business Plan 397**

    Developing the Business Plan 397

    The Plan Is Obsolete at the Printer 398

Work in Progress—Bent Knees Required 398

The Plan Is Not the Business 398

Some Tips from the Trenches 399

Sell, Sell, Sell! Myopia 400

The Dehydrated Business Plan 400

Who Develops the Business Plan? 401

A Closer Look at the What 401

    The Relationship between Goals and Action 401

    Segmenting and Integrating Information 401

    Establishing Action Steps 402

Preparing a Business Plan 402

    A Complete Business Plan 402

Chapter Summary 404

Study Questions 404

Mind Stretchers 405

Exercise *The Business Plan Guide* 406

**Case:** *Douglas Ranalli and Shae Plimley* 421

## PART IV

### Financing Entrepreneurial Ventures

**13 Entrepreneurial Finance 443**

Venture Financing: The Entrepreneur's Achilles' Heel 443

    Financing Management Myopia: It Can't Happen to Me 444

    Critical Financing Issues 445

    Entrepreneurial Finance: The Owner's Perspective 446

Determining Capital Requirements 449

    Financial Strategy Framework 449

    Free Cash Flow: Burn Rate, OOC, and TTC 450

Crafting Financial and Fund-Raising Strategies 451

    Critical Variables 451

    Financial Life Cycles 452

    Investor Preferences 452

Chapter Summary 452

Study Questions 453

Mind Stretchers 454

**Case:** *Fax International Japan (A)* 455

**14 Obtaining Venture and Growth Capital 469**

The Capital Markets Food Chain 469

Cover Your Equity 470

Timing 471

Angels and Informal Investors 471

    Who They Are 471

    Finding Informal Investors 472

    Contacting Investors 473

    Evaluation Process 473

    The Decision 473

Venture Capital: Gold Mines and Tar Pits 473

What Is Venture Capital? 474

The Venture Capital Industry 475

    The Booming 90s 476

    Beyond the Crash of 2000: The Venture Capital Cycle Repeats Itself 477

The Venture Capital Process 479

    Identifying Venture Capital Investors 481

Dealing with Venture Capitalists 483	Tar Pits Facing Entrepreneurs 508
Questions the Entrepreneur Can Ask 483	Staged Capital Commitments 509
Due Diligence: A Two-Way Street 483	Structuring the Deal 510
Other Equity Sources 484	What Is a Deal? 510
Small Business Administration's 7(a) Guaranteed Business Loan Program 484	Understanding the Bets 51 1
Small Business Investment Companies 484	Some of the Lessons Learned: The Dog in the Suitcase 51 2
Mezzanine Capital 485	Negotiations 512
Private Placements 485	What Is Negotiable? 512
Initial Public Stock Offerings 486	The Specific Issues Entrepreneurs Typically Face 51 3
Private Placement after Going Public 488	The Term Sheet 514
Employee Stock Ownership Plans (ESOPs) 489	Black Box Technology, Inc., Term Sheet 515
Keeping Current about Capital Markets 489	Sand Traps 515
Chapter Summary 489	Strategic Circumference 515
Study Questions 490	Legal Circumference 515
Mind Stretchers 490	Attraction to Status and Size 515
<b>Case: Hindman &amp; Company 491</b>	Unknown Territory 516
<b>15 The Deal: Valuation, Structure, and Negotiation 501</b>	Opportunity Cost 516
The Art and Craft of Valuation 501	Underestimation of Other Costs 517
What Is a Company's Worth? 501	Greed 517
Determinants of Value 501	Being Too Anxious 517
Long-Term Value Creation versus Quarterly Earnings 502	Impatience 517
Psychological Factors Determining Value 502	Take-the-Money-and-Run-Myopia 518
A Theoretical Perspective 502	Chapter Summary 518
Investor's Required Rate of Return (IRR) 502	Study Questions 518
Investor's Required Share of Ownership 502	Mind Stretchers 518
The Theory of Company Pricing 503	<b>Case: Bridge Capital Investors, Inc. 519</b>
The Reality 504	<b>16 Obtaining Debt Capital 531</b>
The Down Round or Cram Down circa 2002 504	A Cyclical Pattern: The Good Old Days Return but Fade Again 531
Valuation Methods 505	A Word of Caution 532
The Venture Capital Method 505	The Lender's Perspective 532
The Fundamental Method 506	Sources of Debt Capital 532
The First Chicago Method 507	Trade Credit 534
Ownership Dilution 507	Commercial Bank Financing 534
Discounted Cash Flow 508	Line of Credit Loans 534
Other Rule-of-Thumb Valuation Methods 508	Time-Sales Finance 535
	Term Loans 535
	Chattel Mortgages and Equipment Loans 536
	Conditional Sales Contracts 536
	Plant Improvement Loans 536
	Commercial Finance Companies 536
	Factoring 537
	Leasing Companies 538
	Before the Loan Decision 539

Approaching and Meeting the Banker 541	Tar Pits: Entrepreneurs Beware 546
What the Banker Wants to Know 541	Beware of Leverage: The ROE Mirage 546
The Lending Decision 543	IRS: Time Bomb for Personal Disaster 547
Lending Criteria 543	Neither a Borrower nor a Lender Be, But If You Must... 547
Loan Restrictions 544	Chapter Summary 547
Convenants to Look For 544	Study Questions 547
Personal Guarantees and the Loan 544	Mind Stretchers 548
Building a Relationship 544	<b>Case: Jiffy Lube International, Inc. 549</b>
The TLC of a Banker or Other Lender 545	
What to Do When the Bank Says No 545	

## **PART V**

### **Startup and After**

<b>17 Managing Rapid Growth: Entrepreneurship Beyond Startup 559</b>	<b>18 The Entrepreneur and the Troubled Company 579</b>
Inventing New Organizational Paradigms 559	When the Bloom Is off the Rose 579
Entrepreneurial Leaders Are Not Administrators or Managers 560	Getting into Trouble—The Causes 580
Breakthrough Strategy: Babson's F. W. Olin Graduate School 560	Getting Out of Trouble 581
Leading Practices of High Growth Companies 560	Predicting Trouble 581
Growing Up Big 561	Net-Liquid-Balance-to-Total-Assets Ratio 582
Stages of Growth Revisited 561	Nonquantitative Signals 582
Core Management Mode 562	The Gestation Period of Crisis 582
The Problem in Rate of Growth 562	The Paradox of Optimism 583
Industry Turbulence 565	The Bloom is off the Rose—Now What? 583
The Importance of Culture and Organizational Climate 566	Decline in Organizational Morale 583
Six Dimensions 566	The Threat of Bankruptcy 584
Approaches to Management 567	Voluntary Bankruptcy 584
Entrepreneurial Management for the 21st Century: Three Breakthroughs 568	Involuntary Bankruptcy 584
Ewing Marion Kauffman and Marion Labs 568	Bargaining Power 584
Jack Stack and Springfield Remanufacturing Corporation 569	Intervention 585
Ralph Stayer and Johnsonville Sausage Company 569	Diagnosis 585
The Chain of Greatness 570	The Turnaround Plan 586
Chapter Summary 571	Longer-Term Remedial Actions 589
Study Questions 571	Chapter Summary 589
Mind Stretchers 572	Study Questions 589
<b>Case: Quick Lube Franchise Corporation (QLFC) 573</b>	Mind Stretchers 589
	<b>Case: EverNet Corporation 590</b>
	<b>19 The Harvest and Beyond 605</b>
	A Journey, Not a Destination 605
	The Journey Can Be Addictive 605
	First Build a Great Company 606



Table of Contents

Create Harvest Options 606  
A Harvest Goal 607  
Crafting a Harvest Strategy: Timing Is  
Vital 608  
Harvest Options 610  
    Capital Cow 610  
    Employee Stock Ownership Plan 610  
    Management Buyout 610  
    Merger, Acquisition, and Strategic  
    Alliance 610  
    Outright Sale 611  
    Public Offering 611  
    Wealth-Building Vehicles 612  
Beyond the Harvest 612  
The Road Ahead: Devise a Personal  
Entrepreneurial Strategy 613  
    Goals Matter—A Lot! 613  
    Values and Principles Matter—  
    A Lot! 613  
Seven Secrets of Success 614  
Chapter Summary 614

Study Questions 614  
Mind Stretchers 614  
Case: *Paul J. Tobin* 615

**20 Crafting a Personal Entrepreneurial  
Strategy 643**

A Conceptual Scheme for Self-  
Assessment 644  
Crafting an Entrepreneurial Strategy 643  
    Profiling the Past 644  
    Profiling the Present 645  
    Getting Constructive Feedback 645  
    Putting it All Together 646  
Thinking Ahead 646  
Chapter Summary 647  
Study Questions 647  
Mind Stretchers 647  
Exercise *Personal Entrepreneurial  
Strategy* 648  
Case: *Boston Communications Group, Inc.* 669

**Index 685**

The New Venture Creation executive education course has been designed to equip nascent entrepreneurs with the skills necessary to start a scalable business. All participants on our Executive Education courses will receive a certificate upon completion of the programme. New Venture Creation is devoted to helping students develop compelling business ideas. This is based not only on the authors'™ well-known research in product and service innovation, but also on their extensive experience as successful entrepreneurs and investors. In the updated Second Edition, part I guides students through six elements that comprise a clearly defined and focused venture: defining your target industry; defining your New Venture Creation is a cross-disciplinary entrepreneurship course open to 9th semester students. The elective equips enrolled students with an entrepreneurial skillset, opportunistic networking and fosters innovation and new business start-ups. This course is aimed at all would-be entrepreneurs, established entrepreneurs and students interested in business development processes. The course is designed as a live case New Venture Creation: Entrepreneurship for the 21st Century, Canadian Edition, addresses the needs of upper-level entrepreneurship and new venture courses. Timmons provides strong, comprehensive theoretical coverage balanced with practical examples and cases, all designed to instruct students on how to formulate, plan for, finance, launch, manage, and eventually harvest a new venture. Timmons, Canadian Edition, is a rigorous, practical, and experiential text. New Venture Creation continues to be the product of experience and considerable research in this field"rooted in real-world application and refined in the classroom. The design and flow of this book are aimed at creating knowledge, skills, and awareness. In a pragmatic way"through text, case studies, and hands-on exercises"students are drawn in to discover critical aspects of entrepreneurship, and what levels of competencies, know-how, experience, attitudes, resources, and networks are required to pursue.