

Entrepreneurship

A group of ideas around entrepreneurship

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Definitions

Entrepreneurship

Entrepreneurship is the implementation of an individual's talent in the resources in which he is available with; and expanding these resources in the future so that one can get individual as well as general i.e. social success.

It comes from the French verb 'entreprendre' which means 'to undertake.'

Entrepreneurship is the act and art of being an entrepreneur or one who undertakes innovations or introducing new things, finance and business acumen in an effort to transform innovations into economic goods.^[1]

This may result in new organizations or may be part of revitalizing mature organizations in response to a perceived opportunity.

The most obvious form of entrepreneurship is that of starting new businesses (referred as startup company); however, in recent years, the term has been extended to include social and political forms of entrepreneurial activity.

When entrepreneurship is describing activities within a firm or large organization it is referred to as intra-preneurship and may include corporate venturing, when large entities spin-off organizations.^[2]

According to Paul Reynolds, entrepreneurship scholar and creator of the Global Entrepreneurship Monitor, "by the time they reach their retirement years, half of all working men in the United States probably have a period of self-employment of one or more years; one in four may have engaged in self-employment for six or more years. Participating in a new business creation is a common activity among U.S. workers over the course of their careers."^[3] And in recent years has been documented by scholars such as David Audretsch to be a major driver of economic growth in both the United States and Western Europe. "As well, entrepreneurship may be defined as the pursuit of opportunity without regard to resources currently controlled (Stevenson,1983)"^[4]

Entrepreneurial activities are substantially different depending on the type of organization and creativity involved. Entrepreneurship ranges in scale from solo projects (even involving the entrepreneur only part-time) to major undertakings creating many job opportunities. Many "high value" entrepreneurial ventures seek venture capital or angel funding (seed money) in order to raise capital to build the business. Angel investors generally seek annualized returns of 20-30% and more, as well as extensive involvement in the business.^[5] Many kinds of organizations now exist to support would-be entrepreneurs including specialized government agencies, business incubators, science parks, and some NGOs. In more recent times, the term entrepreneurship has been extended to include elements not related necessarily to business formation activity such as conceptualizations of entrepreneurship as a specific mindset (see also entrepreneurial mindset) resulting in entrepreneurial initiatives e.g. in the form of social entrepreneurship, political entrepreneurship, or knowledge entrepreneurship have emerged.

History

The entrepreneur is a factor in microeconomics, and the study of entrepreneurship reaches back to the work of Richard Cantillon and Adam Smith in the late 17th and early 18th centuries, but was largely ignored theoretically until the late 19th and early 20th centuries and empirically until a profound resurgence in business and economics in the last 40 years.

In the 20th century, the understanding of entrepreneurship owes much to the work of economist Joseph Schumpeter in the 1930s and other Austrian economists such as Carl Menger, Ludwig von Mises and Friedrich von Hayek.

Schumpeter

In Schumpeter, an entrepreneur is a person who is willing and able to convert a new idea or invention into a successful innovation.^[6] Entrepreneurship employs what Schumpeter called "the gale of creative destruction" to replace in whole or in part inferior innovations across markets and industries, simultaneously creating new products including new business models. In this way, creative destruction is largely responsible for the dynamism of industries and long-run economic growth. The supposition that entrepreneurship leads to economic growth is an interpretation of the residual in endogenous growth theory and as such is hotly debated in academic economics. An alternate description posited by Israel Kirzner suggests that the majority of innovations may be much more incremental improvements such as the replacement of paper with plastic in the construction of a drinking straw.

For Schumpeter, entrepreneurship resulted in new industries but also in new combinations of currently existing inputs. Schumpeter's initial example of this was the combination of a steam engine and then current wagon making technologies to produce the horseless carriage. In this case the innovation, the car, was transformational but did not require the development of a new technology, merely the application of existing technologies in a novel manner. It did not immediately replace the horsedrawn carriage, but in time, incremental improvements which reduced the cost and improved the technology led to the complete practical replacement of beast drawn vehicles in modern transportation. Despite Schumpeter's early 20th-century contributions, traditional microeconomic theory did not formally consider the entrepreneur in its theoretical frameworks (instead assuming that resources would find each other through a price system). In this treatment the entrepreneur was an implied but unspecified actor, but it is consistent with the concept of the entrepreneur being the agent of x-efficiency.

Different scholars have described entrepreneurs as, among other things, bearing risk. For Schumpeter, the entrepreneur did not bear risk: the capitalist did.

Knight and Drucker

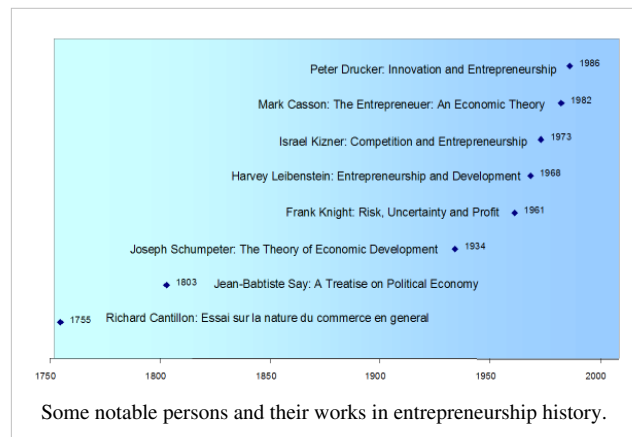
For Frank H. Knight^[7] (1921) and Peter Drucker (1970) entrepreneurship is about taking risk. The behavior of the entrepreneur reflects a kind of person willing to put his or her career and financial security on the line and take risks in the name of an idea, spending much time as well as capital on an uncertain venture.

Knight classified three types of uncertainty.

- Risk, which is measurable statistically (such as the probability of drawing a red color ball from a jar containing 5 red balls and 5 white balls).
- Ambiguity, which is hard to measure statistically (such as the probability of drawing a red ball from a jar containing 5 red balls but with an unknown number of white balls).
- True Uncertainty or Knightian Uncertainty, which is impossible to estimate or predict statistically (such as the probability of drawing a red ball from a jar whose number of red balls is unknown as well as the number of other colored balls).

The acts of entrepreneurship are often associated with true uncertainty, particularly when it involves bringing something really novel to the world, whose market never exists. However, even if a market already exists, there is no guarantee that a market exists for a particular new player in the cola category.

The place of the disharmony-creating and idiosyncratic entrepreneur in traditional economic theory (which describes many efficiency-based ratios assuming uniform outputs) presents theoretic quandaries. William Baumol has added greatly to this area of economic theory and was recently honored for it at the 2006 annual meeting of the American Economic Association.^[8]



The entrepreneur is widely regarded as an integral player in the business culture of American life, and particularly as an engine for job creation and economic growth. Robert Sobel published *The Entrepreneurs: Explorations Within the American Business Tradition* in 1974. Zoltan Acs and David Audretsch have produced an edited volume surveying Entrepreneurship as an academic field of research,^[9] and more than a hundred scholars around the world track entrepreneurial activity, policy and social influences as part of the Global Entrepreneurship Monitor (GEM)^[10] and its associated reports. nowadays, information on this site is not available

Characteristics of an entrepreneur

Entrepreneurs have many of the same character traits as leaders,^[11] similar to the early great man theories of leadership; however trait-based theories of entrepreneurship are increasingly being called into question. Entrepreneurs are often contrasted with managers and administrators who are said to be more methodical and less prone to risk-taking. Such person-centric models of entrepreneurship have shown to be of questionable validity, not least as many real-life entrepreneurs operate in teams rather than as single individuals. Still, a vast literature studying the entrepreneurial personality argues that certain traits seem to be associated with entrepreneurs:

- **Bird** - mercurial, that is, prone to insights, brainstorming, deceptions, ingeniousness and resourcefulness. they are cunning, opportunistic, creative, and unsentimental.
- **Busenitz and Barney** - prone to overconfidence and over generalizations.
- **Cole** - found there are four types of entrepreneur: the innovator, the calculating inventor, the over-optimistic promoter, and the organization builder. These types are not related to the personality but to the type of opportunity the entrepreneur faces.
- **Collins and Moore** - tough, pragmatic people driven by needs of independence and achievement. They seldom are willing to submit to authority.
- **Cooper, Woo, & Dunkelberg** - argue that entrepreneurs exhibit extreme optimism in their decision-making processes.
- **John Howkins** - focused specifically on creative entrepreneurship. He found that entrepreneurs in the creative industries needed a specific set of traits including the ability to prioritise ideas over data, to be nomadic and to learn endlessly.^[12]
- **David McClelland** - primarily motivated by an overwhelming need for achievement and strong urge to build.

Qualities

1. Disciplined

These individuals are focused on making their businesses work, and eliminate any hindrances or distractions to their goals. They have overarching strategies and outline the tactics to accomplish them. Successful entrepreneurs are disciplined enough to take steps every day toward the achievement of their objectives.

2. Confidence

The entrepreneur does not ask questions about whether they can succeed or whether they are worthy of success. They are confident with the knowledge that they will make their businesses succeed. They exude that confidence in everything they do.

3. Open Minded

Entrepreneurs realize that every event and situation is a business opportunity. Ideas are constantly being generated about workflows and efficiency, people skills and potential new businesses. They have the ability to look at everything around them and focus it toward their goals.

4. Self Starter

Entrepreneurs know that if something needs to be done, they should start it themselves. They set the parameters and make sure that projects follow that path. They are proactive, not waiting for someone to give them permission.

5. Competitive

Many companies are formed because an entrepreneur knows that they can do a job better than another. They need to win at the sports they play and need to win at the businesses that they create. An entrepreneur will highlight their own company's track record of success.

6. Creativity

One facet of creativity is being able to make connections between seemingly unrelated events or situations. Entrepreneurs often come up with solutions which are the synthesis of other items. They will repurpose products to market them to new industries.^[13]

7. Determination

Entrepreneurs are not thwarted by their defeats. They look at defeat as an opportunity for success. They are determined to make all of their endeavors succeed, so will try and try again until it does. Successful entrepreneurs do not believe that something cannot be done.

8. Strong people skills

The entrepreneur has strong communication skills to sell the product and motivate employees. Most successful entrepreneurs know how to motivate their employees so the business grows overall. They are very good at highlighting the benefits of any situation and coaching others to their success.

9. Strong work ethic

The successful entrepreneur will often be the first person to arrive at the office and the last one to leave. They will come in on their days off to make sure that an outcome meets their expectations. Their mind is constantly on their work, whether they are in or out of the workplace.

10. Passion

Passion is the most important trait of the successful entrepreneur. They genuinely love their work. They are willing to put in those extra hours to make the business succeed because there is a joy their business gives which goes beyond the money. The successful entrepreneur will always be reading and researching ways to make the business better.

Successful entrepreneurs want to see what the view is like at the top of the business mountain. Once they see it, they want to go further. They know how to talk to their employees, and their businesses soar as a result.

Concept

It has assumed super importance for accelerating economic growth both in developed and developing countries. It promotes capital formation and creates wealth in country. It is hope and dreams of millions of individuals around the world. It reduces unemployment and poverty and it is a pathway to prosper. Entrepreneurship is the process of exploring the opportunities in the market place and arranging resources required to exploit these opportunities for long term gain. It is the process of planning, organising, opportunities and assuming. Thus it is a risk of business enterprise. It may be distinguished as an ability to take risk independently to make utmost earnings in the market. It is a creative and innovative skill and adapting response to environment.

Promotion

Given entrepreneurship's potential to support economic growth, it is the policy goal of many governments to develop a culture of entrepreneurial thinking. This can be done in a number of ways: by integrating entrepreneurship into education systems, legislating to encourage risk-taking, and national campaigns. An example of the latter is the United Kingdom's Enterprise Week.

Outside of the political world, research has been conducted on the presence of entrepreneurial theories in doctoral economics programs. Dan Johansson, fellow at the Ratio Institute in Sweden, finds such content to be sparse. He fears this will dilute doctoral programs and fail to train young economists to analyze problems in a relevant way.^[14]

Many of these initiatives have been brought together under the umbrella of Global Entrepreneurship Week, a worldwide celebration and promotion of youth entrepreneurship, which started in 2008. Empirical evidence obtained from real-world data also suggests that in transition economy and in troubled times, entrepreneurship and creativity are factors that can save the corporate sector from plunging into a downward spiral of unemployment, downsizing and further chaos.^[15]

Financial Bootstrapping

Financial bootstrapping is a term used to cover different methods for avoiding using the financial resources of external investors. Bootstrapping can be defined as “a collection of methods used to minimize the amount of outside debt and equity financing needed from banks and investors”.^[16] The use of private credit card debt is the most known form of bootstrapping, but a wide variety of methods are available for entrepreneurs. While bootstrapping involves a risk for the founders, the absence of any other stakeholder gives the founders more freedom to develop the company. Many successful companies including Dell Computers and Facebook were founded this way.

There are different types of bootstrapping:

- Owner financing
- Sweat equity
- Minimization of the accounts receivable
- Joint utilization
- Delaying payment
- Minimizing inventory
- Subsidy finance
- Personal Debt

External financing

Many businesses need more capital than can be provided by the owners themselves, and in this case a range of options are available including:

- Angel Investors
- Venture capital investors.
- Crowd funding
- Hedge Funds
- Alternative Asset Management

Some of these source provide not only funds, but also financial oversight, accountability for carrying out tasks and meeting milestones, and in some cases business contacts and experience - in many cases in return for an equity stake.

Entrepreneurship Education

Most prominently entrepreneurship education and the teaching of the academic culture of entrepreneurship, remains with the catalysts of the Australian Graduate school of Entrepreneurship (AGSE) at Swinburne University of Technology, Melbourne, Australia which in March 1989 formed the first Master of Entrepreneurship and Innovation which teaches the corporate, technological and socio-environmental importance of entrepreneurship, also Swinburne has an undergraduate entrepreneurship program that teaches entrepreneurship from a grass-roots level.

Entrepreneurship Research

Most Entrepreneurial research hot spots occur within a large entrepreneurial community such as the Masters of entrepreneurship and innovation (MEI) alumni and entrepreneurship PHD students at Swinburne University and Babson college which focuses primarily on the characteristics of entrepreneurs and the changes within the business culture as the result of more entrepreneurial management and thinking.

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External links

- Starting a Business (<http://www.irs.gov/businesses/small/article/0,,id=99336,00.html>)
- Stockholm School of Entrepreneurship (SSES) (<http://www.sses.se>)
- The Ewing Marion Kauffman Foundation (<http://www.kauffman.org>)
- Entrepreneurship.gov (<http://www.entrepreneurship.gov>)
- Enterprise UK (<http://www.enterpriseuk.org>)
- Entrepreneurship 101 Duke University video series (<http://www.youtube.com/watch?v=Qt92fIdynmM&feature=relmfu>)
- Stanford University's Entrepreneurship Corner 2000 free videos and podcasts (<http://ecorner.stanford.edu/>)

Entrepreneur

The term **entrepreneur** (i/ˌɒntrəprəˈnɜː/) is a loanword from French, and is commonly used to describe an individual who organizes and operates a business or businesses, taking on financial risk to do so. The term was first defined by the Irish-French economist Richard Cantillon as the person who pays a certain price for a product to resell it at an uncertain price, thereby making decisions about obtaining and using the resources while consequently admitting the risk of enterprise. The term first appeared in the French Dictionary "Dictionnaire Universel de Commerce" of Jacques des Bruslons published in 1723.

Over time, scholars have defined the term in different ways. Here are some prominent definitions.

- 1803: Jean-Baptiste Say: An entrepreneur is an economic agent who unites all means of production- land of one, the labour of another and the capital of yet another and thus produces a product. By selling the product in the market he pays rent of land, wages to labour, interest on capital and what remains is his profit. He shifts economic resources out of an area of lower and into an area of higher productivity and greater yield.
- 1934: Schumpeter: Entrepreneurs are innovators who use a process of shattering the status quo of the existing products and services, to set up new products, new services.
- 1961: David McClelland: An entrepreneur is a person with a high need for achievement [N-Ach]. He is energetic and a moderate risk taker.
- 1964: Peter Drucker: An entrepreneur searches for change, responds to it and exploits opportunities. Innovation is a specific tool of an entrepreneur hence an effective entrepreneur converts a source into a resource.
- 1971: Kilby: Emphasizes the role of an imitator entrepreneur who does not innovate but imitates technologies innovated by others. Are very important in developing economies.
- 1975: Albert Shapero: Entrepreneurs take initiative, accept risk of failure and have an internal locus of control.

- 1975: Howard Stevenson: Entrepreneurship is "the pursuit of opportunity without regard to resources currently controlled."^[1]
- 1983: G. Pinchot: Intrapreneur is an entrepreneur within an already established organization.^[2]
- 1985: W.B. Gartner: Entrepreneur is a person who started a new business where there was none before.^[3]

Influences and characteristics of entrepreneurial behavior

Management skill and strong team building abilities are often perceived as essential leadership attributes^[4] for successful entrepreneurs. Robert B. Reich considers leadership, management ability, and team-building as essential qualities of an entrepreneur. This concept has its origins in the work of Richard Cantillon in his *Essai sur la Nature du Commerce en* (1755) and Jean-Baptiste Say^[5] in his *Treatise on Political Economy*.

Psychological studies show that the psychological propensities for male and female entrepreneurs are more similar than different. A growing body of work shows that entrepreneurial behavior is dependent on social and economic factors. For example, countries with healthy and diversified labor markets or stronger safety nets show a more favorable ratio of opportunity-driven rather than necessity-driven women entrepreneurs. Empirical studies suggest that male entrepreneurs possess strong negotiating skills and consensus-forming abilities.

Research studies that explore the characteristics and personality traits of, and influences on, the entrepreneur have come to differing conclusions. Most, however, agree on certain consistent entrepreneurial traits and environmental influences. Although certain entrepreneurial traits are required, entrepreneurial behaviours are also dynamic and influenced by environmental factors. Shane and Venkataraman (2000) argue that the entrepreneur is solely concerned with opportunity recognition and exploitation, although the opportunity that is recognised depends on the type of entrepreneur; while Ucbasaran et al. (2001) argue there are many different types contingent upon environmental and personal circumstances.

Jesper Sørensen has argued that some of the most significant influences on an individual's decision to become an entrepreneur are workplace peers and the social composition of the workplace. In researching the likelihood of becoming an entrepreneur based upon working with former entrepreneurs, Sørensen discovered a correlation between working with former entrepreneurs and how often these individuals become entrepreneurs themselves, compared to those who did not work with entrepreneurs.^[6] The social composition of the workplace can influence entrepreneurship in workplace peers by proving a possibility for success, causing a "He can do it, why can't I?" attitude. As Sørensen stated, "When you meet others who have gone out on their own, it doesn't seem that crazy."^[6]

Perception of entrepreneurs

The ability of entrepreneurs to innovate is thought to relate to innate traits such as extroversion and a proclivity for risk-taking. According to Schumpeter, the capabilities of innovating, introducing new technologies, increasing efficiency and productivity, or generating new products or services, are characteristic qualities of entrepreneurs. Entrepreneurs are catalysts for economic change, and researchers argue that entrepreneurs are highly creative individuals with a tendency to imagine new solutions by finding opportunities for profit or reward.^[7] Largely due to the influence of Schumpeter's heroic conceptions of entrepreneurs, it is widely maintained that entrepreneurs are unusual individuals. In line with this view, there is an emerging research tradition investigating the genetic factors that are perceived to make entrepreneurs so distinctive (Nicolaou and Shane, 2009).

However, there are also critical perspectives that attribute these research attitudes to oversimplified methodological and/or philosophical assumptions (Gartner, 2001). For example, it has been argued that entrepreneurs are not that distinctive, but that it is in essence unrealistic preconceptions about "non-entrepreneurs" that maintain laudatory portraits of "entrepreneurs" (Ramoglou, 2011).

Classification of entrepreneurs

A. Based on functional characteristics

1. Innovative entrepreneur: Such entrepreneurs introduce new goods or new methods of production or discover new markets or reorganize the enterprise.
 1. EX: new product, new ways of product, new markets and reorganise the enterprise.
2. Imitative or adoptive entrepreneur: Such entrepreneurs don't innovate, they copy technology or technique of others.
 1. EX: Chinese mobiles.
3. Fabian entrepreneur: Such entrepreneur display grates situation and scepticism in experimenting with any change in their enterprise. They change only when there is a serious threat to the very existence of the enterprise.
4. Drone entrepreneurs: Such entrepreneurs are characterised by a diehard conservatism and may even be prepared to suffer the losses.
 1. EX: Acc. To MC Kinsey in 2015, 110-130 million people will be unemployed out of which 90-100 million people will be Fresher.

B. Based on development angle

1. Prime mover: This entrepreneur sets in motion a powerful sequence of development expansion and diversification of business.
 1. EX: Ambani
2. Manager: such an entrepreneur doesn't initiate expansion and its content in just staying in business.
3. Minor innovator: This entrepreneur contributes to economic progress by finding better use for existing resources.
 1. EX: minimum wastage maximum production.
4. Satellite: This entrepreneur assumes a suppliers role and slowly move towards a productive enterprise.
5. Local trading: such entrepreneur limits his enterprise to the local market.

C. Based on entrepreneurs business

1. Manufacturing
2. Wholesaling
3. Retailing
4. Service

Based on personality traits

1. The improver: They have unwavering to run these businesses with high integrity and ethics.
 2. The advisor: "Customer is right and we must do everything to please him" because company is built by advisors and advisors become customer focused.
 3. The superstar: All depends upon the charisma and on the high energy of the superstar CEO.
 1. EX: Richard Branson (400 co's/Virgin coin), Larry Page (Google), Lt. Steve Jobs (Apple), Ratan Tata (Tata sons).
 4. The artists: Are highly creative type, very conscious about business. If feedback is constructive i.e. positive than also lets go with negative self-image.
 1. EX: Aamir Khan, Michael Dell (Dell), MC Cormich (EMI).
 5. The visionary: Too focused on dreams with little focused on reality.
 1. EX: Jack Welch (GE), Bill Gates (Microsoft), Kishore Biyani (Future Group), Warren Buffet (Berkshire Hathaway), Sam Walton (Wall Mart).
-

6. The analyst: More focused on fixing problems in a systematic way.
 1. EX: Gordon Hore (Intel), Rana Kapoor (Yes Bank), Gautam Adani (Adani Groups)
7. The fireball: A business owned and operated by a fireball is full of life, energy and optimism. They have “A get it done attitude in a playful manner”.
 1. EX: Malcolm Forbes – Forbes magazine
8. The hero: Have an incredible will and ability to lead the world and your business through challenges.
9. The healer: They provide nurturing harmony to their business, they have uncanny abilities to survive and persists inner calm.
 1. EX: Dr. Bindeshwar Pathak (Sulabh International), Kumar Manglam Birla (Son of L.M Birla).
1. The Opportunistic: take advantage of opportunities as they occur.
 1. EX: Mark Zuckerberg

Theory-based Typologies

Recent advances in entrepreneur researcher indicate that the differences in entrepreneurs and the heterogeneity in their behaviors and actions can be traced back to their the founder's identity. For instance, Fauchart and Gruber (2011) have recently utilized social identity theory to illustrate that entrepreneurs can be distinguished in three main types: Darwinians, Communitarians and Missionaries. These types of founders not only diverge in fundamental ways in terms of their self-views and their social motivations in entrepreneurship, but also engage fairly differently in new firm creation.

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Entrepreneurial mindset

The term **entrepreneur** ( [/ˌɒntreˈprɒːnɜː/](#)) is a loanword from French, and is commonly used to describe an individual who organizes and operates a business or businesses, taking on financial risk to do so. The term was first defined by the Irish-French economist Richard Cantillon as the person who pays a certain price for a product to resell it at an uncertain price, thereby making decisions about obtaining and using the resources while consequently admitting the risk of enterprise. The term first appeared in the French Dictionary "Dictionnaire Universel de Commerce" of Jacques des Bruslons published in 1723.

Over time, scholars have defined the term in different ways. Here are some prominent definitions.

- 1803: Jean-Baptiste Say: An entrepreneur is an economic agent who unites all means of production- land of one, the labour of another and the capital of yet another and thus produces a product. By selling the product in the market he pays rent of land, wages to labour, interest on capital and what remains is his profit. He shifts economic resources out of an area of lower and into an area of higher productivity and greater yield.
- 1934: Schumpeter: Entrepreneurs are innovators who use a process of shattering the status quo of the existing products and services, to set up new products, new services.
- 1961: David McClelland: An entrepreneur is a person with a high need for achievement [N-Ach]. He is energetic and a moderate risk taker.
- 1964: Peter Drucker: An entrepreneur searches for change, responds to it and exploits opportunities. Innovation is a specific tool of an entrepreneur hence an effective entrepreneur converts a source into a resource.
- 1971: Kilby: Emphasizes the role of an imitator entrepreneur who does not innovate but imitates technologies innovated by others. Are very important in developing economies.
- 1975: Albert Shapero: Entrepreneurs take initiative, accept risk of failure and have an internal locus of control.
- 1975: Howard Stevenson: Entrepreneurship is "the pursuit of opportunity without regard to resources currently controlled."^[1]
- 1983: G. Pinchot: Intrapreneur is an entrepreneur within an already established organization.^[2]
- 1985: W.B. Gartner: Entrepreneur is a person who started a new business where there was none before.^[3]

Influences and characteristics of entrepreneurial behavior

Management skill and strong team building abilities are often perceived as essential leadership attributes^[4] for successful entrepreneurs. Robert B. Reich considers leadership, management ability, and team-building as essential qualities of an entrepreneur. This concept has its origins in the work of Richard Cantillon in his *Essai sur la Nature du Commerce en* (1755) and Jean-Baptiste Say^[5] in his *Treatise on Political Economy*.

Psychological studies show that the psychological propensities for male and female entrepreneurs are more similar than different. A growing body of work shows that entrepreneurial behavior is dependent on social and economic factors. For example, countries with healthy and diversified labor markets or stronger safety nets show a more favorable ratio of opportunity-driven rather than necessity-driven women entrepreneurs. Empirical studies suggest that male entrepreneurs possess strong negotiating skills and consensus-forming abilities.

Research studies that explore the characteristics and personality traits of, and influences on, the entrepreneur have come to differing conclusions. Most, however, agree on certain consistent entrepreneurial traits and environmental influences. Although certain entrepreneurial traits are required, entrepreneurial behaviours are also dynamic and influenced by environmental factors. Shane and Venkataraman (2000) argue that the entrepreneur is solely concerned with opportunity recognition and exploitation, although the opportunity that is recognised depends on the type of entrepreneur; while Ucbasaran et al. (2001) argue there are many different types contingent upon environmental and personal circumstances.

Jesper Sørensen has argued that some of the most significant influences on an individual's decision to become an entrepreneur are workplace peers and the social composition of the workplace. In researching the likelihood of becoming an entrepreneur based upon working with former entrepreneurs, Sørensen discovered a correlation between working with former entrepreneurs and how often these individuals become entrepreneurs themselves, compared to those who did not work with entrepreneurs.^[6] The social composition of the workplace can influence entrepreneurship in workplace peers by proving a possibility for success, causing a "He can do it, why can't I?" attitude. As Sørensen stated, "When you meet others who have gone out on their own, it doesn't seem that crazy."^[6]

Perception of entrepreneurs

The ability of entrepreneurs to innovate is thought to relate to innate traits such as extroversion and a proclivity for risk-taking. According to Schumpeter, the capabilities of innovating, introducing new technologies, increasing efficiency and productivity, or generating new products or services, are characteristic qualities of entrepreneurs. Entrepreneurs are catalysts for economic change, and researchers argue that entrepreneurs are highly creative individuals with a tendency to imagine new solutions by finding opportunities for profit or reward.^[7] Largely due to the influence of Schumpeter's heroic conceptions of entrepreneurs, it is widely maintained that entrepreneurs are unusual individuals. In line with this view, there is an emerging research tradition investigating the genetic factors that are perceived to make entrepreneurs so distinctive (Nicolaou and Shane, 2009).

However, there are also critical perspectives that attribute these research attitudes to oversimplified methodological and/or philosophical assumptions (Gartner, 2001). For example, it has been argued that entrepreneurs are not that distinctive, but that it is in essence unrealistic preconceptions about "non-entrepreneurs" that maintain laudatory portraits of "entrepreneurs" (Ramoglou, 2011).

Classification of entrepreneurs

A. Based on functional characteristics

1. Innovative entrepreneur: Such entrepreneurs introduce new goods or new methods of production or discover new markets or reorganize the enterprise.
 1. EX: new product, new ways of product, new markets and reorganise the enterprise.
2. Imitative or adoptive entrepreneur: Such entrepreneurs don't innovate, they copy technology or technique of others.
 1. EX: Chinese mobiles.
3. Fabian entrepreneur: Such entrepreneur display grates situation and scepticism in experimenting with any change in their enterprise. They change only when there is a serious threat to the very existence of the enterprise.
4. Drone entrepreneurs: Such entrepreneurs are characterised by a diehard conservatism and may even be prepared to suffer the losses.
 1. EX: Acc. To MC Kinsey in 2015, 110-130 million people will be unemployed out of which 90-100 million people will be Fresher.

B. Based on development angle

1. Prime mover: This entrepreneur sets in motion a powerful sequence of development expansion and diversification of business.
 1. EX: Ambani
2. Manager: such an entrepreneur doesn't initiate expansion and its content in just staying in business.
3. Minor innovator: This entrepreneur contributes to economic progress by finding better use for existing resources.
 1. EX: minimum wastage maximum production.
4. Satellite: This entrepreneur assumes a suppliers role and slowly move towards a productive enterprise.
5. Local trading: such entrepreneur limits his enterprise to the local market.

C. Based on entrepreneurs business

1. Manufacturing
2. Wholesaling
3. Retailing
4. Service

Based on personality traits

1. The improver: They have unwavering to run these businesses with high integrity and ethics.
2. The advisor: "Customer is right and we must do everything to please him" because company is built by advisors and advisors become customer focused.
3. The superstar: All depends upon the charisma and on the high energy of the superstar CEO.
 1. EX: Richard Branson (400 co's/Virgin coin), Larry Page (Google), Lt. Steve Jobs (Apple), Ratan Tata (Tata sons).
4. The artists: Are highly creative type, very conscious about business. If feedback is constructive i.e. positive than also lets go with negative self-image.
 1. EX: Aamir Khan, Michael Dell (Dell), MC Cormich (EMI).
5. The visionary: Too focused on dreams with little focused on reality.
 1. EX: Jack Welch (GE), Bill Gates (Microsoft), Kishore Biyani (Future Group), Warren Buffet (Berkshire Hathaway), Sam Walton (Wall Mart).

6. The analyst: More focused on fixing problems in a systematic way.
 1. EX: Gordon Hore (Intel), Rana Kapoor (Yes Bank), Gautam Adani (Adani Groups)
7. The fireball: A business owned and operated by a fireball is full of life, energy and optimism. They have “A get it done attitude in a playful manner”.
 1. EX: Malcolm Forbes – Forbes magazine
8. The hero: Have an incredible will and ability to lead the world and your business through challenges.
9. The healer: They provide nurturing harmony to their business, they have uncanny abilities to survive and persists inner calm.
 1. EX: Dr. Bindeshwar Pathak (Sulabh International), Kumar Manglam Birla (Son of L.M Birla).
1. The Opportunistic: take advantage of opportunities as they occur.
 1. EX: Mark Zuckerberg

Theory-based Typologies

Recent advances in entrepreneur researcher indicate that the differences in entrepreneurs and the heterogeneity in their behaviors and actions can be traced back to their the founder's identity. For instance, Fauchart and Gruber (2011) have recently utilized social identity theory to illustrate that entrepreneurs can be distinguished in three main types: Darwinians, Communitarians and Missionaries. These types of founders not only diverge in fundamental ways in terms of their self-views and their social motivations in entrepreneurship, but also engage fairly differently in new firm creation.

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Startup company

A **startup company** or **startup** is a company or temporary organization designed to search for a repeatable and scalable business model.^[1] These companies, generally newly created, are in a phase of development and research for markets. The term became popular internationally during the dot-com bubble when a great number of dot-com companies were founded.

Lately, the term startup has been associated mostly with technological ventures designed for high-growth. Paul Graham, founder of one of the top startup accelerators in the world, defines a startup as: "A startup is a company designed to grow fast. Being newly founded does not in itself make a company a startup. Nor is it necessary for a startup to work on technology, or take venture funding, or have some sort of "exit." The only essential thing is growth. Everything else we associate with startups follows from growth."^[2]

Evolution of a startup company

Startup companies can come in all forms, but the phrase "startup company" is often associated with high growth, technology oriented companies. Investors are generally most attracted to those new companies distinguished by their risk/reward profile and scalability. That is, they have lower bootstrapping costs, higher risk, and higher potential return on investment. Successful startups are typically more scalable than an established business, in the sense that they can potentially grow rapidly with limited investment of capital, labor or land.

Startups encounter several unique options for funding. Venture capital firms and angel investors may help startup companies begin operations, exchanging cash for an equity stake. In practice though, many startups are initially funded by the founders themselves. Factoring is another option, though not unique to start ups. Some new funding opportunities are also developing in crowd funding.^[3]

A critical task in setting up a business is to conduct research in order to validate, assess and develop the ideas or business concepts in addition to opportunities to establish further and deeper understanding on the ideas or business concepts as well as their commercial potential.

If a company's value is based on its technology, it is often equally important for the business owners to obtain intellectual property protection for their idea. The newsmagazine *The Economist* estimated that up to 75% of the value of US public companies is now based on their intellectual property (up from 40% in 1980).^[4] Often, 100% of a small startup company's value is based on its intellectual property. As such, it is important for technology oriented start up companies to develop a sound strategy for protecting their intellectual capital as early as possible.^[5]

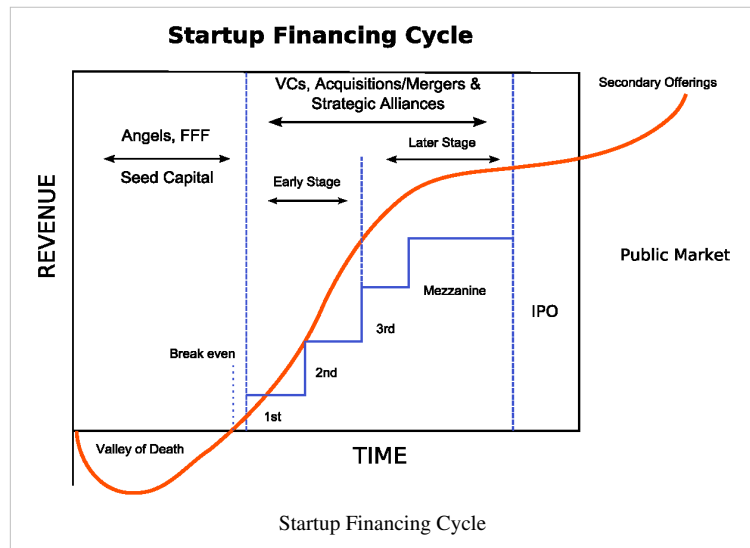
Startup companies, particularly those associated with new technology, sometimes produce huge returns to their creators and investors – a recent example of such was Google, whose creators are now billionaires through their share ownership. However, the failure rate of startup companies is very high.^[6]

While there are startup businesses created in all types of businesses, and all over the world, some locations and business sectors are particularly associated with startup companies. The Internet bubble of the late 1990s was associated with huge numbers of internet startup companies, some selling the technology to provide internet access, others using the internet to provide services. Most of this startup activity was located in Silicon Valley, an area of northern California renowned for the high level of startup company activity:

The spark that set off the explosive boom of “Silicon startups” in Stanford Industrial Park was a personal dispute in 1957 between employees of Shockley Semiconductor and the company’s namesake and founder, Nobel laureate and co-inventor of the transistor William Shockley... (His employees) formed Fairchild Semiconductor immediately following their departure...

After several years, Fairchild gained its footing, becoming a formidable presence in this sector. Its founders began to leave to start companies based on their own, latest ideas and were followed on this path by their own former leading employees... The process gained momentum and what had once began in a Stanford’s research park became a veritable startup avalanche... Thus, over the course of just 20 years, a mere eight of Shockley’s former employees gave forth 65 new enterprises, which then went on to do the same...^[7]

A company may cease to be a startup as it passes various milestones, such as becoming profitable, or becoming publicly traded in an IPO, or ceasing to exist as an independent entity via a merger or acquisition. Companies may also fail and cease to operate altogether. Recently the patent assets of these failed startup companies are being purchased by what are derogatorily known as "Patent trolls" who then take the patents from the companies and assert those patents against companies that might be infringing the technology covered by the patent.^[8]



Co-Founders

Co-Founders are people involved in the cultivation of startup companies. Anyone can be a Co-Founder, and an existing company can also be a Co-Founder, but frequently Co-Founders are entrepreneurs, hackers, venture capitalists, web developers, web designers and others involved in the ground level of a new, often high tech, venture.

There is no formal, legal definition of what makes somebody a Co-Founder. The right to call oneself a Co-Founder can be established through an agreement with one's fellow Co-Founders or with permission of the board of directors, investors or shareholders of a startup company. When there is no definitive agreement, disputes about who the Co-Founders were can arise. One well-known example of a dispute over who can be called a Co-Founder can be observed in the story of a lawsuit against Elon Musk by a Co-Founder of Tesla Motors in which it was alleged that he did not have the right to consider himself a Co-Founder merely because he provided a large amount of capital and was instrumental in saving the company from bankruptcy.^[9]

Finding a co-founder may be a complicated issue. Agreeing on the terms and conditions of partnerships, exit strategies and compensations from the beginning, improves the understanding of what is expected of each party.^[10]

Due to the rise of tech startups, Technical co-founders (programmers) are specially sought after. Some co-founder dating sites are now available online to fill this gap.

Internal startups

Large or well-established companies often try to promote innovation by setting up "internal startups", new business divisions that operate at arm's length from the rest of the company. Examples include Target Corporation (which began as an internal startup of the Dayton's department store chain) and threedegrees, a product developed by an internal startup of Microsoft.^[11]

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External links

- Access to Capital: Fostering Job Creation and Innovation Through High-Growth Startups: Hearing before the Subcommittee on Economic Policy of the Committee on Banking, Housing, and Urban Affairs, United States Senate, One Hundred Twelfth Congress, First Session ... July 20, 2011 (<http://purl.fdlp.gov/GPO/gpo22743>)

Entrepreneurial economics

Entrepreneurial Economics is the study of the entrepreneur and entrepreneurship within the economy. The accumulation of factors of production per se does not explain economic development. They are necessary inputs in production, but they are not sufficient for economic growth.^[1]

Human creativity and productive entrepreneurship are needed to combine these inputs in profitable ways, and hence an institutional environment that encourages free entrepreneurship becomes the ultimate determinant of economic growth. Thus, the entrepreneur and entrepreneurship should take center stage in any effort to explain long-term economic development. Early economic theory, however did not lay proper attention to the entrepreneur.

“The theoretical firm is entrepreneurless – the Prince of Denmark has been expunged from the discussion of Hamlet”. This oft-quoted observation was made by William J. Baumol^[2] in the *American Economic Review*. The article was a prod to the economics profession to attend to this neglected factor.

If entrepreneurship remains as important to the economy as ever, then the continuing failure of mainstream economics to adequately account for entrepreneurship indicates that fundamental principles require re-evaluation. The characteristics of an entrepreneurial economy are high levels of innovation combined with high level of entrepreneurship which result in the creation of new ventures as well as new sectors and industries.

Entrepreneurship is difficult to analyse using the traditional tools of economics e.g. calculus and general equilibrium models. Current textbooks have only a passing reference to the concept of entrepreneurship and the entrepreneur. Equilibrium models are central to mainstream economics, and exclude entrepreneurship. Joseph Schumpeter and Israel Kirzner argued that entrepreneurs do not tolerate equilibrium.

Studies about entrepreneurs in Economics, Psychology and Sociology largely relate to four major currents of thought. Early thinkers such as Max Weber emphasized its occurrence in the context of a religious belief system, thereby suggesting that some belief systems do not encourage entrepreneurship. This contention has, however, been challenged by many sociologists. Some thinkers such as K Samuelson believe that there is no relationship between religion, economic development and entrepreneurship. Karl Marx considered the economic system and mode of production as its sole determinants. Weber suggested a direct relation between the ethics and economic system as both interacted intensively.

Another current of thought underscores the motivational aspects of personal achievement. This overemphasized the individual and his values, attitudes and personality. This thought, however, has been severely criticized by many scholars such as Kilby (1971) and Kunkel (1971).

International entrepreneurs

EDI Ahmedabad, of India conducted a study under the guidance of Prof. David C. McClelland, a renowned behavioral scientist, to identify a set of competencies or characteristics of successful entrepreneurs in India, Malawi & Ecuador. He found that certain characteristics are cross-culturally valid, and concluded that these competencies are necessary in varying measures in all the cultures and countries and linked these with the nature of socialization in the society.

A third group of thinkers emphasized the existence of economic entrepreneurship. The economists assume that factors of production are highly mobile; that inputs and outputs are homogenous, and that producers, consumers and resource owners have knowledge of all open possibilities. In underdeveloped countries, ideal conditions do not exist. As such, the entrepreneurship envisaged by economists cannot be developed in such a country by considering the economic dimensions alone.

A fourth school of thought attached importance to the managerial aspects. They emphasized perception of market opportunities as well as operational skills, required to run a business or an industry.

A critical evaluation of these four major currents of thought however, reveals certain common characteristics. These include the identification and perception of economic opportunity, technical, organizational and behavioral skills, managerial competence, and motivation to achieve results.

The various concepts and theories propounded by researchers seem to indicate that the developing entrepreneurs in a society depend upon closely interlinked economic, social, religious, cultural and psychological variables.

Prof. Frank Knight^[3] Hawley, A. C. Pigou and others opine that entrepreneurs bear the uncertainty & risk of production. The theory alone is unable to explain the occupational choice question. To build a development model of entrepreneurship it is necessary to look at some of the other characteristics that help explain why some people are entrepreneurs; risk may be a factor, but it is not the only one.

Schumpeter

Schumpeter's concept is a synthesis of three different notions of entrepreneur: risk bearer, innovator and a coordinator cum manager. He assigned the role of innovator to the entrepreneur and not to the capitalist. Capitalists supply capital while entrepreneurs innovate. He stated that 'whatever the type, everyone is entrepreneur only when he actually carries out a new combination and loses that character as soon as he has built up his business, when he settles to running it as other people run their business'.^[4] The focus here is not on a category of person, but on a function. He was perhaps influenced by his family history.

The entrepreneur has been perceived as someone who disrupts an existing equilibrium. Innovation is a chaotic, unpredictable economic process, which cannot be modeled using the equilibrium based analytical methods used in mainstream economic theory. Challenging 'fundamental principles' like equilibrium models, rational agent, maximization paradigm, the traditional production function, by applying insight from other disciplines like theoretical physics (thermodynamics, entropy) might be the way forward in the study of entrepreneurial economics. Two types of theories attempt to explain entrepreneurs. One is a sociological approach, which suggests that as a result of withdrawal of status, some social classes will work to fill the void and be more entrepreneurial. The other is an economic approach which implies entrepreneurs identify and fill market gaps.

Following Schumpeter (entrepreneur as an innovator), Leibenstein postulates that the entrepreneurs are gap-fillers i.e. they have the ability to perceive market opportunities and to develop new goods/services that are not currently being supplied. He postulates that entrepreneurs have the special ability to connect markets and make up for market deficiencies. Additionally, drawing from the theories of J.B. Say and Cantillon, Leibenstein suggests that entrepreneurs have the ability to combine various inputs into new innovations in order to satisfy unfulfilled market demand.^[5]

Drucker

Peter F. Drucker defines an entrepreneur as a person who looks out for change, responds to it and exploits the opportunity generated by the change. It may mean a new business, new product or a new service. He claims that a resource becomes an economic resource only when an entrepreneur finds a use for it. Some thinkers suggest that entrepreneurs are to be found in social sectors e.g., non-governmental organizations as well, i.e., social entrepreneurs. Another innovator type is the intrapreneur, who perform entrepreneurial functions, but bear less risk, because they work in an existing organization. These people innovate, but bear less risk, and also may not get rewards in proportion to the success of the new venture, but they certainly are change agents.^[6]

Coase

Coase believes economics has become a "theory-driven" subject that has moved into a paradigm in which conclusions take precedence over problems. "If you look at a page of a scientific journal like Nature," he said, "every few weeks you have statements such as, 'We'll have to think it out again. These results aren't going the way we thought they would.' Well, in economics, the results always go the way we thought they would because we approach the problems in the same way, only asking certain questions. Entrepreneurial Economics challenges fundamental principles, using insights from models and theories in the natural sciences."

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Business and Plans

Angel investor

An **angel investor** or **angel** (also known as a **business angel** or **informal investor**) is an affluent individual who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity. A small but increasing number of angel investors organize themselves into **angel groups** or **angel networks** to share research and pool their investment capital, as well as to provide advice to their portfolio companies.

Description

Source and extent of funding

Angels typically invest their own funds, unlike venture capitalists who manage the pooled money of others in a professionally-managed fund.^{[1][2]} Although typically reflecting the investment judgment of an individual, the actual entity that provides the funding may be a trust, business, limited liability company, investment fund, or other vehicle. A Harvard report^[3] by William R. Kerr, Josh Lerner, and Antoinette Schoar provides evidence that angel-funded startup companies have historically been less likely to fail than companies that rely on other forms of initial financing.

Angel capital fills the gap in start-up financing between "friends and family"—(sometimes humorously given the acronym FFF, which stands for "friends, family and fools")^[4] who provide seed funding—and formal venture capital. Although it is usually difficult to raise more than a few hundred thousand dollars from friends and family, most traditional venture capital funds are usually not able to make or evaluate small investments under US\$1–2 million.^[5] Thus, angel investment is a common second round of financing for high-growth start-ups, and accounts in total for almost as much money invested annually as all venture capital funds combined, but into more than 60 times as many companies (US\$20.1 billion vs. \$23.26 billion in the US in 2010, into 61,900 companies vs. 1,012 companies).^{[6][7]}

There is no "set amount" for angel investors, and the range can go anywhere from a few thousand, to a few million dollars. In a large shift from 2009, in 2010 healthcare/medical accounted for the largest share of angel investments, with 30% of total angel investments (vs. 17% in 2009), followed by software (16% vs. 19% in 2007), biotech (15% vs. 8% in 2009), industrial/energy (8% vs. 17% in 2009), retail (5% vs. 8% in 2009) and IT services (5%).^{[6][8]} Angel financing, while more readily available than venture financing, is still extremely difficult to raise.^[9] However some new models are developing that are trying to make this easier.^[10]

Investment profile

Angel investments bear extremely high risk and are usually subject to dilution from future investment rounds. As such, they require a very high return on investment. Because a large percentage of angel investments are lost completely when early stage companies fail, professional angel investors seek investments that have the potential to return at least 10 or more times their original investment within 5 years, through a defined exit strategy, such as plans for an initial public offering or an acquisition. Current 'best practices' suggest that angels might do better setting their sights even higher, looking for companies that will have at least the potential to provide a 20x-30x return over a five- to seven-year holding period. After taking into account the need to cover failed investments and the multi-year holding time for even the successful ones, however, the actual effective internal rate of return for a typical successful portfolio of angel investments is, in reality, typically as 'low' as 20-30%.^[11] While the investor's

need for high rates of return on any given investment can thus make angel financing an expensive source of funds, cheaper sources of capital, such as bank financing, are usually not available for most early-stage ventures.

Profile of investor community

The term "angel" originally comes from Broadway where it was used to describe wealthy individuals who provided money for theatrical productions. In 1978, William Wetzel,^[12] then a professor at the University of New Hampshire and founder of its Center for Venture Research, completed a pioneering study on how entrepreneurs raised seed capital in the USA, and he began using the term "angel" to describe the investors that supported them.

Angel investors are often retired entrepreneurs or executives, who may be interested in angel investing for reasons that go beyond pure monetary return. These include wanting to keep abreast of current developments in a particular business arena, mentoring another generation of entrepreneurs, and making use of their experience and networks on a less than full-time basis. Thus, in addition to funds, angel investors can often provide valuable management advice and important contacts. Because there are no public exchanges listing their securities, private companies meet angel investors in several ways, including referrals from the investors' trusted sources and other business contacts; at investor conferences and symposia; and at meetings organized by groups of angels where companies pitch directly to investor in face-to-face meetings.

According to the Center for Venture Research, there were 258,000 active angel investors in the U.S. in 2007.^[13] According to literature reviewed by the US Small Business Administration, the number of individuals in the US who made an angel investment between 2001 and 2003 is between 300,000 and 600,000.^[14] Beginning in the late 1980s, angels started to coalesce into informal groups with the goal of sharing deal flow and due diligence work, and pooling their funds to make larger investments. Angel groups are generally local organizations made up of 10 to 150 accredited investors interested in early-stage investing. In 1996 there were about 10 angel groups in the United States and are over 200 as of 2006.^[15]

The past few years, particularly in North America, have seen the emergence of networks of angel groups, through which companies that apply for funding to one group are then brought before other groups to raise additional capital.^[16]

Angel investing in the US

Geographically, Silicon Valley dominates the destination of angel funds, receiving 39% of the \$7.5B invested in US-based companies throughout Q2 2011, 3-4 times as much as the total amount invested within New England.^[7] Total investments in 2011 were \$22.5 billion, an increase of 12.1 percent over 2010 when investments totaled \$20.1 billion.^[17] In the United States, angels are generally accredited investors in order to comply with current SEC regulations, although the JOBS Act of 2012 will loosen those requirements starting in January of 2013.

Angel investing in the UK

A study by NESTA^[18] in 2009 estimated that there were between 4,000 and 6,000 angel investors in the UK with an average investment size of £42,000 per investment. Furthermore, each angel investor on average acquired 8 per cent of the venture in the deal with 10 per cent of investments accounting for more than 20 per cent of the venture.

In terms of returns, 35 percent of investments produced returns of between one and five times of the initial investment, whilst 9 per cent produced returns of multiples of ten times or more. The mean return, however, was 2.2 times investment in 3.6 years and an approximate internal rate of return of 22 per cent gross.

The UK Business Angel market grew in 2009/2010 and, despite recessionary concerns, continues to show signs of growth.^{[19][20]}

Angel investing in the World

In 2012 in the Russian Federation the 'International Business Angels Assembly' ^[21] took place. This was an exclusive event devoted to private investing into innovative projects in Eastern Europe.^[22]

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External links

- WBAA directory of national angel investor associations (<http://www.wbaa.biz/members.html>)
- Angel Resource Institute (<http://www.angelcapitaleducation.org/>)
- University of New Hampshire Center for Venture Research (http://www.wsbe.unh.edu/Centers_CVR/news.cfm)

Business case

A **business case** captures the reasoning for initiating a project or task. It is often presented in a well-structured written document, but may also sometimes come in the form of a short verbal argument or presentation. The logic of the business case is that, whenever resources such as money or effort are consumed, they should be in support of a specific business need. An example could be that a software upgrade might improve system performance, but the "business case" is that better performance would improve customer satisfaction, require less task processing time, or reduce system maintenance costs. A compelling business case adequately captures both the quantifiable and unquantifiable characteristics of a proposed project.

Business cases can range from comprehensive and highly structured, as required by formal project management methodologies, to informal and brief. Information included in a formal business case could be the background of the project, the expected business benefits, the options considered (with reasons for rejecting or carrying forward each option), the expected costs of the project, a gap analysis and the expected risks. Consideration should also be given to the option of doing nothing including the costs and risks of inactivity. From this information, the justification for the project is derived. Note that it is not the job of the project manager to build the business case, this task is usually the responsibility of stakeholders and sponsors.^[1]

Reasons for creating a business case

Business cases are created to help decision-makers ensure that:

- the proposed initiative will have value and relative priority compared to alternative initiatives
- the firm has the capability to deliver the benefits
- the firm's dedicated resources are working on the highest value opportunities
- projects with inter-dependencies are undertaken in the optimum sequence
- the performance of initiatives is monitored objectively based on the objectives and expected benefits laid out in the business case

Development and approval process

The business case process should be designed to be:

- adaptable - tailored to the size and risk of the proposal
 - consistent - the same basic business issues are addressed by every project
 - business oriented - concerned with the business capabilities and impact, rather than having a technical focus
 - comprehensive - includes all factors relevant to a complete evaluation
 - understandable - the contents are clearly relevant, logical and, although demanding, are simple to complete and evaluate
 - measurable - all key aspects can be quantified so their achievement can be tracked and measured
 - transparent - key elements can be justified directly
 - accountable - accountabilities and commitments for the delivery of benefits and management of costs are clear.
-

Development

Development of the business case should not be mechanical. Indeed, the case must demonstrate that the issues have been thought through, the full benefits will be realized on time, any technical aspects have been thoroughly evaluated and cost, and track and measure their achievement. In general, the process of developing a business case involves financial decomposition, opportunity identification, opportunity qualification, benefit validation, and finally finalization of the business case.

A business case should contain some or all of the following information types (depending on the size, timing, scale and availability of information):

- Reference - project name/reference, origins/background/current state
- Context - business objectives/opportunities, business strategic alignment (priority)
- Value proposition - desired business outcomes, outcomes roadmap, business benefits (by outcome), quantified benefits value, costs/ROI financial scenarios, risks/costs of not proceeding, project risks (to project, benefits and business)
- Focus - problem/solution scope, assumptions/constraints, options identified/evaluated, size, scale and complexity assessment
- Deliverables - outcomes, deliverables and benefits planned, organizational areas impacted (internally and externally), key stakeholders, dependencies
- Workload - approach, phase/stage definitions (project (change) activities, technical delivery activities, workload estimate/breakdown, project plan and schedule, critical path)
- Required resources - project leadership team, project governance team, team resources, funding
- Commitments (required) - Project controls, reporting processes, deliverables schedule, financial budget/schedule

Review and approval

At various stages in the project, the business case should be reviewed to ensure that:

- The justification is still valid,
- The project will deliver the solution to the business need.

The result of a review may be the termination or amendment of the project. The business case may also be subject to amendment if the review concludes that the business need has abated or changed, this will have a knock on effect on the project.

Public sector projects

Many public sector projects are now required to justify their need through a business case. In the public sector, the business case is argued in terms of cost/benefit analysis, which may include both financial and non-financial cost and benefits. This allows the business to take into account societal and environmental benefits, allowing a more comprehensive understanding of economic impacts.

Notes

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Business plan

A **business plan** is a formal statement of a set of business goals, the reasons they are believed attainable, and the plan for reaching those goals. It may also contain background information about the organization or team attempting to reach those goals.

Business plans may also target changes in perception and branding by the customer, client, taxpayer, or larger community. When the existing business is to assume a major change or when planning a new venture, a 3 to 5 year business plan is required, since investors will look for their annual return in that timeframe.^[1]

Audience

Business plans may be internally or externally focused. Externally focused plans target goals that are important to external stakeholders, particularly financial stakeholders. They typically have detailed information about the organization or team attempting to reach the goals. With for-profit entities, external stakeholders include investors and customers.^[2] External stake-holders of non-profits include donors and the clients of the non-profit's services.^[3] For government agencies, external stakeholders include tax-payers, higher-level government agencies, and international lending bodies such as the International Monetary Fund, the World Bank, various economic agencies of the United Nations, and development banks.

Internally focused business plans target intermediate goals required to reach the external goals. They may cover the development of a new product, a new service, a new IT system, a restructuring of finance, the refurbishing of a factory or a restructuring of the organization. An internal business plan is often developed in conjunction with a balanced scorecard or a list of critical success factors. This allows success of the plan to be measured using non-financial measures. Business plans that identify and target internal goals, but provide only general guidance on how they will be met are called strategic plans.

Operational plans describe the goals of an internal organization, working group or department.^[4] Project plans, sometimes known as project frameworks, describe the goals of a particular project. They may also address the project's place within the organization's larger strategic goals.^[5]

Content

Business plans are decision-making tools. There is no fixed content for a business plan. Rather, the content and format of the business plan is determined by the goals and audience. A business plan represents all aspects of business planning process declaring vision and strategy alongside sub-plans to cover marketing, finance, operations, human resources as well as a legal plan, when required. A business plan is a summary of those disciplinary plans.

For example, a business plan for a non-profit might discuss the fit between the business plan and the organization's mission. Banks are quite concerned about defaults, so a business plan for a bank loan will build a convincing case for the organization's ability to repay the loan. Venture capitalists are primarily concerned about initial investment, feasibility, and exit valuation. A business plan for a project requiring equity financing will need to explain why current resources, upcoming growth opportunities, and sustainable competitive advantage will lead to a high exit valuation.

Preparing a business plan draws on a wide range of knowledge from many different business disciplines: finance, human resource management, intellectual property management, supply chain management, operations management, and marketing, among others.^[6] It can be helpful to view the business plan as a collection of sub-plans, one for each of the main business disciplines.^[7]

"... a good business plan can help to make a good business credible, understandable, and attractive to someone who is unfamiliar with the business. Writing a good business plan can't guarantee success, but it can go a long way toward reducing the odds of failure."^[7]

Presentation formats

The format of a business plan depends on its presentation context. It is common for businesses, especially start-ups to have three or four formats for the same business plan:

- an "elevator pitch" - a three minute summary of the business plan's executive summary. This is often used as a teaser to awaken the interest of potential funders, customers, or strategic partners.
- a pitch deck with oral narrative - a hopeful, entertaining slide show and oral narrative that is meant to trigger discussion and interest potential investors in reading the written presentation. The content of the presentation is usually limited to the executive summary and a few key graphs showing financial trends and key decision making benchmarks. If a new product is being proposed and time permits, a demonstration of the product may also be included.
- a written presentation for external stakeholders - a detailed, well written, and pleasingly formatted plan targeted at external stakeholders.
- an internal operational plan - a detailed plan describing planning details that are needed by management but may not be of interest to external stakeholders. Such plans have a somewhat higher degree of candor and informality than the version targeted at external stakeholders and others.

Typical structure for a business plan for a start up venture^[8]

- cover page and table of contents
- executive summary
- business description
- business environment analysis
- industry background
- competitor analysis
- market analysis
- marketing plan
- operations plan
- management summary
- financial plan
- attachments and milestones

Typical questions addressed by a business plan for a start up venture^[9]

- What problem does the company's product or service solve? What niche will it fill?
 - What is the company's solution to the problem?
 - Who are the company's customers, and how will the company market and sell its products to them?
 - What is the size of the market for this solution?
 - What is the business model for the business (how will it make money)?
 - Who are the competitors and how will the company maintain a competitive advantage?
 - How does the company plan to manage its' operations as it grows?
 - Who will run the company and what makes them qualified to do so?
-

- What are the risks and threats confronting the business, and what can be done to mitigate them?
- What are the company's capital and resource requirements?
- What are the company's historical and projected financial statements?

Revisiting the business plan

Cost overruns and revenue shortfalls

Cost and revenue estimates are central to any business plan for deciding the viability of the planned venture. But costs are often underestimated and revenues overestimated resulting in later cost overruns, revenue shortfalls, and possibly non-viability. During the dot-com bubble 1997-2001 this was a problem for many technology start-ups. Reference class forecasting has been developed to reduce the risks of cost overruns and revenue shortfalls and thus generate more accurate business plans

Legal and liability issues

Disclosure requirements

An externally targeted business plan should list all legal concerns and financial liabilities that might negatively affect investors. Depending on the amount of funds being raised and the audience to whom the plan is presented, failure to do this may have severe legal consequences.

Limitations on content and audience

Non disclosure agreements (NDAs) with third parties, non-compete agreements, conflicts of interest, privacy concerns, and the protection of one's trade secrets may severely limit the audience to which one might show the business plan. Alternatively, they may require each party receiving the business plan to sign a contract accepting special clauses and conditions.

This situation is complicated by the fact that many venture capitalists will refuse to sign an NDA before looking at a business plan, lest it put them in the untenable position of looking at two independently developed look-alike business plans, both claiming originality. In such situations one may need to develop two versions of the business plan: a stripped down plan that can be used to develop a relationship and a detail plan that is only shown when investors have sufficient interest and trust to sign an NDA.

Open business plans

Traditionally business plans have been highly confidential and quite limited in audience. The business plan itself is generally regarded as secret. However the emergence of free software and open source has opened the model and made the notion of an open business plan possible.

An open business plan is a business plan with unlimited audience. The business plan is typically web published and made available to all.

In the free software and open source business model, trade secrets, copyright and patents can no longer be used as effective locking mechanisms to provide sustainable advantages to a particular business and therefore a secret business plan is less relevant in those models.

While the origin of the open business plan model is in the free software and Libre services arena, the concept is likely applicable to other domains.

Uses

- Venture capital
 - Venture capital assessment of business plans - focus on qualitative factors such as team.
 - Business plan contests - provides a way for venture capitalists to find promising projects.
 - The better the business plan, the better your chances of landing that big initial investment.
- Within corporations
 - Fundraising is the primary purpose for many business plans, since they are related to the inherent probable success/failure of the company risk.
 - Total quality management (TQM) is a business management strategy aimed at embedding awareness of quality in all organizational processes. TQM has been widely used in manufacturing, education, call centers, government, and service industries, as well as NASA space and science programs.
 - Management by objectives (MBO) is a process of agreeing upon objectives (as can be detailed within business plans) within an organization so that management and employees agree to the objectives and understand what they are in the organization.
 - Strategic planning is an organization's process of defining its strategy, or direction, and making decisions on allocating its resources to pursue this strategy, including its capital and people. Business plans can help decision makers see how specific projects relate to the organization's strategic plan.
- Education
 - Business plans are used in some primary and secondary programs to teach economic principles.^[10] Wikiversity has a Lunar Boom Town project where students of all ages can collaborate with designing and revising business models and practice evaluating them to learn practical business planning techniques and methodology.

Not for profit businesses

The business goals may be defined both for non-profit or for-profit organizations. For-profit business plans typically focus on financial goals, such as profit or creation of wealth. Non-profit, as well as government agency business plans tend to focus on the "organizational mission" which is the basis for their governmental status or their non-profit, tax-exempt status, respectively—although non-profits may also focus on optimizing revenue.

The primary difference between profit and non-profit organizations is that "for-profit" organizations look to maximize wealth versus non-profit organizations, which look to provide a greater good to society. In non-profit organizations, creative tensions may develop in the effort to balance mission with "margin" (or revenue).

Satires

The business plan is the subject of many satires. Satires are used both to express cynicism about business plans and as an educational tool to improve the quality of business plans. For example,

- Five Criteria for a successful business plan in biotech^[11] uses Dilbert comic strips to remind people of what *not* to do when researching and writing a business plan for a biotech start-up. Scott Adams, the author of Dilbert, is an MBA graduate (U.C. Berkeley) who sees humor as a critical tool that can improve the behavior of businesses and their managers.^[12] He has written numerous critiques of business practices, including business planning. The website Dilbert.com - Games^[13] has a mission statement generator that satirizes the wording often found in mission statements. His book *The Dilbert Principle – A Cubicle's Eye View of Bosses, Meetings, Management Fads & Other Workplace Afflictions* discusses the foibles of management and their plans as depicted in the Dilbert comic strips by Scott Adams.
- In the article "South Park's" Investing Lesson^[14], The Motley Fool columnist "Fool on the Hill" uses the Underpants Gnomes to illustrate the fallacy of focusing on goals without a clear implementation strategy. The

Underpants Gnomes episode satirizes the business plans of the Dot-com era.

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The business school advises students that "To create a robust business plan, teams must take a comprehensive view of the enterprise and incorporate management-practice knowledge from every first-semester course." It is increasingly common for business schools to use business plan projects to provide an opportunity for students to integrate knowledge learned through their courses.
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Business model

A **business model** describes the rationale of how an organization creates, delivers, and captures value^[1] (economic, social, cultural, or other forms of value). The process of business model construction is part of business strategy.

In theory and practice the term business model is used for a broad range of informal and formal descriptions to represent core aspects of a business, including purpose, offerings, strategies, infrastructure, organizational structures, trading practices, and operational processes and policies. The literature has provided very diverse interpretations and definitions of a business model. A systematic review and analysis of manager responses to a survey defines business models as the design of organizational structures to enact a commercial opportunity.^[2] Further extensions to this design logic emphasize the use of narrative or coherence in business model descriptions as mechanisms by which entrepreneurs create extraordinarily successful growth firms.^[3]

Whenever a business is established, it either explicitly or implicitly employs a particular business model that describes the architecture of the value creation, delivery, and capture mechanisms employed by the business enterprise. The essence of a business model is that it defines the manner by which the business enterprise delivers value to customers, entices customers to pay for value, and converts those payments to profit: it thus reflects management's hypothesis about what customers want, how they want it, and how an enterprise can organize to best meet those needs, get paid for doing so, and make a profit.^[4]

Business models are used to describe and classify businesses (especially in an entrepreneurial setting), but they are also used by managers inside companies to explore possibilities for future development. Also, well known business models operate as recipes for creative managers.^[5] Business models are also referred to in some instances within the context of accounting for purposes of public reporting.

History

Over the years, business models have become much more sophisticated. The *bait and hook* business model (also referred to as the "razor and blades business model" or the "tied products business model") was introduced in the early 20th century. This involves offering a basic product at a very low cost, often at a loss (the "bait"), then charging compensatory recurring amounts for refills or associated products or services (the "hook"). Examples include: razor (bait) and blades (hook); cell phones (bait) and air time (hook); computer printers (bait) and ink cartridge refills (hook); and cameras (bait) and prints (hook). A variant of this model is Adobe, a software developer that gives away its document reader free of charge but charges several hundred dollars for its document writer.

In the 1950s, new business models came from McDonald's Restaurants and Toyota. In the 1960s, the innovators were Wal-Mart and Hypermarkets. The 1970s saw new business models from FedEx and Toys R Us; the 1980s from Blockbuster, Home Depot, Intel, and Dell Computer; the 1990s from Southwest Airlines, Netflix, eBay, Amazon.com, and Starbucks.

Today, the type of business models might depend on how technology is used. For example, entrepreneurs on the internet have also created entirely new models that depend entirely on existing or emergent technology. Using technology, businesses can reach a large number of customers with minimal costs.

Theoretical and empirical insights to business models

Design Logic and Narrative Coherence

Design logic views the business model as an outcome of creating new organizational structures or changing existing structures to pursue a new opportunity. Gerry George and Adam Bock (2011) conducted a comprehensive literature review and surveyed managers to understand how they perceived the components of a business model. In that analysis, these authors show that there is a design logic behind how entrepreneurs and managers perceive and explain their business model. In further extensions to the design logic, George and Bock (2012) use case studies and the IBM survey data on business models in large companies to describe how CEOs and entrepreneurs create narratives or stories in a coherent manner to move the business from one opportunity to another. They also show that when the narrative is incoherent or the components of the story are misaligned that these businesses tend to fail. They recommend ways in which the entrepreneur or CEO can create strong narratives for change.

Business Model 2.0

Chen (2009) pointed out that the business model in the twenty-first century has to take into account the capabilities of Web 2.0, such as collective intelligence, network effects, user generated content, and the possibility of self-improving systems. He suggested that the service industry such as the airline, traffic, transportation, hotel, restaurant, Information and Communications Technology and Online gaming industries will be able to benefit in adopting business models that take into account the characteristics of Web 2.0. He also emphasized that Business Model 2.0 has to take into account not just the technology effect of Web 2.0 but also the networking effect. He gave the example of the success story of Amazon in making huge profits each year by developing a full blown open platform that supports a large and thriving community of companies that re-use Amazon's On Demand commerce services.^[6]

Complementarities of business models between partnering firms

Studying collaborative research and the accessing of external sources of technology, Hummel et al. (2010) found that in deciding on business partners, it is important to make sure that both parties' business models are complementary.^[7] For example, they found that it was important to identify the value drivers of potential partners by analyzing their business models, and that it is beneficial to find partner firms that understand key aspects of our own firm's business model.^[8]

Applications

Malone et al.^[9] at MIT found that some business models, as defined by them, indeed performed better than others in a dataset consisting of the largest U.S. firms, in the period 1998 through 2002, while they did not prove whether the existence of a business model mattered.

In the context of the Software-Cluster, which is funded by the German Federal Ministry of Education and Research, a business model wizard^[10] for software companies has been developed. It supports the design and analysis of software business models. The tool's underlying concept and data were published in various scientific publications.^[11]

The concept of a business model has been incorporated into certain accounting standards. For example, the International Accounting Standards Board (IASB) utilizes an "entity's business model for managing the financial assets" as a criterion for determining whether such assets should be measured at amortized cost or at fair value in its financial instruments accounting standard, IFRS 9.^{[12][13][14][15]} At least two members of the U.S. based Financial Accounting Standards Board (FASB) have expressed the position that the business model of an entity should be used as a criterion for the classification of financial liabilities.^[16] The concept of business model has also been introduced into the accounting of deferred taxes under International Financial Reporting Standards with 2010 amendments to IAS 12 addressing deferred taxes related to investment property.^{[17][18][19]}

Both IASB and FASB have proposed using the concept of business model in the context of reporting a lessor's lease income and lease expense within their joint project on accounting for leases.^{[20][21][22]} The concept has also been proposed as an approach for determining the measurement and classification when accounting for insurance contracts.^{[23][24]} As a result of the increasing prominence the concept of business model has received in the context of financial reporting, the European Financial Reporting Advisory Group (EFRAG), which advises the European Union on endorsement of financial reporting standards, commenced a project on the "Role of the Business Model in Financial Reporting" in 2011.^[25]

Examples of Business models

In the early history of business models it was very typical to define business model types such as bricks-and-mortar or e-broker. However, these types usually describe only one aspect of the business (most often revenue model). Therefore, more recent literature on business models concentrates on describing business model as a whole instead of one most visible aspects.

The following examples provide an overview for various business model types that have been in discussion since the invention of term *business model*:

- Bricks and clicks business model

Business model by which a company integrates both offline (*bricks*) and online (*clicks*) presences. One example of the bricks-and-clicks model is when a chain of stores allows the user to order products online, but lets them pick up their order at a local store.

- Collective business models

Business organization or association typically composed of relatively large numbers of businesses, tradespersons or professionals in the same or related fields of endeavor, which pools resources, shares information or provides other benefits for their members.

- Cutting out the middleman model

The removal of intermediaries in a supply chain: "cutting out the middleman". Instead of going through traditional distribution channels, which had some type of intermediate (such as a distributor, wholesaler, broker, or agent), companies may now deal with every customer directly, for example via the Internet.

- Direct sales model

Direct selling is marketing and selling products to consumers directly, away from a fixed retail location. Sales are typically made through party plan, one-to-one demonstrations, and other personal contact arrangements. A text book definition is: "The direct personal presentation, demonstration, and sale of products and services to consumers, usually in their homes or at their jobs."^[26]

- Distribution business models, various

- Fee in, free out

Business model which works by charging the first client a fee for a service, while offering that service free of charge to subsequent clients.

- Franchise

Franchising is the practice of using another firm's successful business model. For the franchisor, the franchise is an alternative to building 'chain stores' to *distribute* goods and avoid investment and liability over a chain. The franchisor's success is the success of the franchisees. The franchisee is said to have a greater incentive than a direct employee because he or she has a direct stake in the business.

- Freemium business model

Business model that works by offering basic Web services, or a basic downloadable digital product, for free, while charging a premium for advanced or special features.^[27]

Other examples of business models are:

- Auction business model
 - All-in-one business model
 - Chemical Leasing
 - Low-cost carrier business model
 - Loyalty business models
 - Monopolistic business model
 - Multi-level marketing business model
 - Network effects business model
 - Online auction business model
 - Online content business model
 - Premium business model
 - Professional open-source model
 - Pyramid scheme business model
 - Razor and blades business model
 - Servitization of products business model
 - Subscription business model
-

Business model frameworks

Technology centric communities have defined "frameworks" for business modeling. These frameworks attempt to define a rigorous approach to defining business value streams. It is not clear, however, to what extent such frameworks are actually important for business planning. A state of the art review on business model frameworks can be found in Krumeich et al. (2012).^[28] In the following some frameworks are introduced.

- Business reference model

Business reference model is a reference model, concentrating on the architectural aspects of the core business of an enterprise, service organization or government agency.

- Component business model

Technique developed by IBM to model and analyze an enterprise. It is a logical representation or map of business components or "building blocks" and can be depicted on a single page. It can be used to analyze the alignment of enterprise strategy with the organization's capabilities and investments, identify redundant or overlapping business capabilities, etc.

- Industrialization of services business model

Business model used in strategic management and services marketing that treats service provision as an industrial process, subject to industrial optimization procedures

- Business Model Canvas

Developed by A. Osterwalder, Yves Pigneur, Alan Smith, and 470 practitioners from 45 countries, the business model canvas ^{[1][29]} is one of the most used frameworks for describing the elements of business models.



Although Webvan failed in its goal of disintermediating the North American supermarket industry, several supermarket chains (like Safeway Inc.) have launched their own delivery services to target the niche market to which Webvan catered.

Related concepts

The process of business model design is part of business strategy. The implementation of a company's business model into organisational structures (e.g. organigrams, workflows, human resources) and systems (e.g. information technology architecture, production lines) is part of a company's business operations.

It is important to understand that business modeling commonly refers to business process design at the operational level, whereas business models and business model design refer to defining the business logic of a company at the strategic level.

The brand is a consequence of and has a symbiotic relationship with the business model since the business model determines the brand promise and the brand equity becomes a feature of the model. Managing this is a task of integrated marketing.

The standard terminology and examples of business models do not apply to most nonprofit organizations, since their sources of income are generally not the same as the beneficiaries. The term **funding model** is generally used instead.^[30]

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Content of a business plan

This article explains what goes into a business plan and why. It is not specific to any particular kind of business plan, nor does it presume any specific layout. Titles of business plan sections are not the same as title sections of this article. For information on the various presentation formats of a business plan see the main article [Business plan](#).

Though business plans have many different presentation formats, business plans typically cover five major content areas:

- Background information
- A marketing plan
- An operational plan
- A financial plan
- A discussion of the decision making criteria that should be used to approve the plan.

Some of these content areas may be more or less important depending on the kind of business plan. There is no fixed content for a business plan. Rather the content and format of the business plan is determined by the goals and audience. A business plan should contain whatever information is needed to decide whether or not to pursue a goal.

Once a business plan has been developed, the key decision making points are usually summarized in an executive summary.

Executive summary

The executive summary summarizes the key points of the business plan. It should define the decision to be made and the reasons for approval. The specific content will be highly dependent on the core purpose and target audience. To get a sense of the difference the purpose and target audience can make, here are three different sets of key points for an executive summary - one for a loan request, one for a start-up seeking venture finance, and one for an internal plan. Items unique to a particular kind of plan are highlighted in bold:

A loan request executive summary might contain the following information:

- Company information: name of company, **years in business**, legal structure, minority and majority owners
- Brief description of project
- **Amount and length of loan**
- Objective reasons why the bank should be confident that the loan will be paid back. This likely will include
 - Financial track record
 - The future revenue stream
 - Any contracts in place that might guarantee the revenue stream is more than just a forecast.

For a new venture, the executive summary might contain:

- Company information: name of company, **proposed legal structure**, current legal structure, minority and majority investors.
- **Amount of investment requested**
- **Expected terminal value**
- **Description of market opportunity**
- **Objective reasons why the market opportunity can be exploited by this particular team**

For an internal project plan, the executive summary might look like this:

- Company information: **not applicable**
 - Description of project
 - **Project mandate: who requested the proposal, who is being assigned to carry it out**
 - **Strategic, tactical** and financial justifications
-

- Summary of resources needed: **staff**, funds, **facilities**

In some cases information will overlap. For example, some of the reasons why a loan is likely to be repaid might equally as well be used as justification for the kind of extraordinary return expected by venture capitalists.

In some cases the business plan as a whole contains similar information, but for one type of plan it is mere detail and for another it is a key decision making factor. For instance, both start-ups and internal projects need staff and facilities. However the staffing and facilities needs are considered details in a plan for start-up financing. In a plan for internal projects they are key elements and, in fact, may be the only resources needed.

Organizational background

In a written plan, information may appear in a separate section, an appendix, or may be omitted all together depending on the nature of the plan. If the plan is directed at people outside of the company, a brief synopsis may appear in the executive summary. This will be supplemented with a more detailed discussion elsewhere in the plan.

Current status

- Number of Employees
- Annual sales figures
- Key product lines
- Location of facilities
- Current stage of development (start-ups)
- Corporate structure (options are):
 - Sole proprietors
 - Partnership
 - Joint Venture
 - Publicly traded corporation
 - Private corporation
 - Limited liability company
 - Public utility
 - Non-profit organization
 - Cooperative
- Names of the majority investor, if any

History

- Founding date
- Major successes
- Strategically valuable learning experiences

Management team

- Board members
 - Owners
 - Senior managers
-

Marketing plan

The marketing plan has five objectives: If the product is a new product with no existing market, one must identify all substitute products. For each significant substitute product one must explain:

- Name, features, why substitute, why proposed product better
- Switching costs and why new product justifies switching
- Expected adoption dynamics
- Expected role once market begins to develop (see above for existing products)

Pricing

- Chosen Price points
- Proposed Pricing strategy

Demand management

In economics, demand management is the art or science of controlling economic demand to avoid a recession. The term is also used to refer to management of the distribution of, and access to goods and services on the basis of needs. An example is social security and welfare services. Rather than increasing budgets for these things, governments may develop policies that allocate existing resources according to a hierarchy of need.

Distribution/Positioning

- Distribution strategy
- List of major distributors
- Current status of negotiations

Promotion and brand development

- Promotion strategy

Operational plan

The plan outlines how one would service their clients cost effectively.

Manufacturing/deployment plan

- Supply chain requirements
- Production inputs
- Facility requirements - size, layout, capacity, location
- Equipment requirements
- Warehousing needs for raw materials, finished goods
 - Space requirements

Information and communications technology plan

- Systems needed
 - Operations: Billing, HR, SCM, CRM, Knowledge bases, etc.
 - Websites: internal, public
- Security and privacy requirements
- Hardware requirements
- Off-the-shelf software needed
- Custom development requirements

Staffing needs

- List of roles
- Management structure
- Head count approval
- For each role
 - Job descriptions
 - Number of employees
 - Proposed compensation
 - Availability
- Training plan

Training requirements

Training requirements should look to address two issues - a **benefit** to motivate staff and **developing the capability** of the organisation to deliver the business objectives. Ideally all training requirements should be based on an assessment of the business plan objectives, the required competence and capability to deliver these objectives and understanding of the current capacity and capability of the organisation. Simple question to ask to assess the appropriateness of the training - as a result of the training how much better will the organization be at delivering its objectives. Remember that training covers a wide range of activities from project work and on the job training to professional qualifications. Most learning takes place outside of formal training activities.

Intellectual property plan

- Intellectual property inventory
- Portfolio development plan

Acquisition plan

Some business plans gain competitive advantage by buying companies up and down the value chain. Some gain competitive advantage by buying up companies and consolidating them. Sometimes a business plan will seek to earn a superior return by adding superior management talent to an existing weak company.

For more information see Mergers and Acquisitions.

When acquisitions form a major part of the business strategy, the acquisition plan needs to be included in the business plan.

- Acquisition strategy
 - Proposed acquisition targets
 - Effect on market structure (if consolidation plan is being proposed)
-

Organizational learning plan

The organizational learning plan discusses what lessons will be learned from the marketing, operational, and finance plans and how those lessons will be consolidated to gain strategic advantage.

- Market sensing - organization's method for collecting information about customers (George Day)
- Strategic Staircase - the accumulation of future competencies by building on existing competencies. (Michael Hays, Costas Markides)

Cost allocation model

If variable costs play an important role in the business plan, it may be helpful to include a cost allocation model. This is particularly true if one has a unique business model that creates competitive advantage by transforming traditionally fixed costs into variable costs.

- Fixed cost
- Variable costs

Research and Development Plan

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Financial plan

For more information, see Financial plan.

Current financing

- Key investors or owners
- Angels, friends, and family
 - Terms, obligations

Funding plan

- IMF
- World Bank

Financial forecasts

- Sometimes called pro formas
 - Balance sheet
 - Income statement
 - Cash flow statement
 - 1-3-5-7 year projections (depends on length of project)
 - For loans, repayment period determines length of projections, i.e. a six month loan doesn't need seven year forecasts
 - For investments point at which returns stabilize (terminal value) determines length of forecast
 - Annual, quarterly, and monthly versions should be provided
 - Graphs of key values often helpful: gross revenue, EBITDA, NPV, etc.
 - Financial portions of the marketing, asset development, and operations are often placed in this section rather than in the section discussing the plan. They are viewed as elaboration on the various line items in the pro-formas.
-

Risk analysis

For more information, see risk analysis.

Risk evaluation

Parts of this section are from an analysis of a business plan

- Market risks - lack of surgeons; large geographical area so that we don't compete against our own clients;
 - New entrants to market
 - Ease of entry
 - Potential threat to market share- advertising companies
 - Slower than expected adoption
- Operational risks
- Staffing risks- imbedding the right candidate for the right surgeon
 - Availability of skilled workforce- x-pharma reps, x-equipment reps
 - Union issues
- Financing risks(banks reluctant to lend loan for initial request or quiet high interest rate which the business has not liquidity to pay it back)
 - Liabilities
 - Poorly worded investor contracts at risk for litigation
 - Investor pull-out
 - Lack of follow-on funding to complete project
- Managerial risks(poor management will lead a business to a loss)
 - Poor board or investor dynamics
 - Agency risk particular to the venture

Risk management plan

Detailed plans are more often found as part of internal plans. Plans written for funders may need to include a high level of description if there are significant controllable risks.

- Methods and procedures to limit liabilities
- Reserve funds
- Continuity of operations plan

Decision making criteria

- Break even analysis
 - Net present value (NPV)
 - Internal rate of return (IRR)
 - Balanced Scorecard
-

Venture capital

Venture capital (VC) is financial capital provided to early-stage, high-potential, high risk, growth startup companies. The venture capital fund makes money by owning equity in the companies it invests in, which usually have a novel technology or business model in high technology industries, such as biotechnology, IT, software, etc. The typical venture capital investment occurs after the seed funding round as growth funding round (also referred to as Series A round) in the interest of generating a return through an eventual realization event, such as an IPO or trade sale of the company. Venture capital is a subset of private equity. Therefore, all venture capital is private equity, but not all private equity is venture capital.^[1]

In addition to angel investing and other seed funding options, venture capital is attractive for new companies with limited operating history that are too small to raise capital in the public markets and have not reached the point where they are able to secure a bank loan or complete a debt offering. In exchange for the high risk that venture capitalists assume by investing in smaller and less mature companies, venture capitalists usually get significant control over company decisions, in addition to a significant portion of the company's ownership (and consequently value).

Venture capital is also associated with job creation (accounting for 2% of US GDP),^[2] the knowledge economy, and used as a proxy measure of innovation within an economic sector or geography. Every year, there are nearly 2 million businesses created in the USA, and 600–800 get venture capital funding . According to the National Venture Capital Association, 11% of private sector jobs come from venture backed companies and venture backed revenue accounts for 21% of US GDP.^[3]

It is also a way in which public and private actors can construct an institution that systematically creates networks for the new firms and industries, so that they can progress. This institution helps in identifying and combining pieces of companies, like finance, technical expertise, know-hows of marketing and business models. Once integrated, these enterprises succeed by becoming nodes in the search networks for designing and building products in their domain.^[4]

History

A venture may be defined as a project prospective of converted into a process with an adequate assumed risk and investment. With few exceptions, private equity in the first half of the 20th century was the domain of wealthy individuals and families. The Vanderbilts, Whitneys, Rockefellers, and Warburgs were notable investors in private companies in the first half of the century. In 1938, Laurance S. Rockefeller helped finance the creation of both Eastern Air Lines and Douglas Aircraft, and the Rockefeller family had vast holdings in a variety of companies. Eric M. Warburg founded E.M. Warburg & Co. in 1938, which would ultimately become Warburg Pincus, with investments in both leveraged buyouts and venture capital.

Origins of modern private equity

Before World War II, money orders (originally known as "development capital") were primarily the domain of wealthy individuals and families. It was not until after World War II that what is considered today to be true private equity investments began to emerge marked by the founding of the first two venture capital firms in 1946: American Research and Development Corporation (ARDC) and J.H. Whitney & Company.^{[5][6]}

ARDC was founded by Georges Doriot, the "father of venture capitalism"^[7] (former dean of Harvard Business School and founder of INSEAD), with Ralph Flanders and Karl Compton (former president of MIT), to encourage private sector investments in businesses run by soldiers who were returning from World War II. ARDC's significance was primarily that it was the first institutional private equity investment firm that raised capital from sources other than wealthy families although it had several notable investment successes as well.^[8] ARDC is

credited with the first trick when its 1957 investment of \$70,000 in Digital Equipment Corporation (DEC) would be valued at over \$355 million after the company's initial public offering in 1968 (representing a return of over 1200 times on its investment and an annualized rate of return of 101%).^[9]

Former employees of ARDC went on and established several prominent venture capital firms including Greylock Partners (founded in 1965 by Charlie Waite and Bill Elfers) and Morgan, Holland Ventures, the predecessor of Flagship Ventures (founded in 1982 by James Morgan).^[10] ARDC continued investing until 1971 with the retirement of Doriot. In 1972, Doriot merged ARDC with Textron after having invested in over 150 companies.

J.H. Whitney & Company was founded by John Hay Whitney and his partner Benno Schmidt. Whitney had been investing since the 1930s, founding Pioneer Pictures in 1933 and acquiring a 15% interest in Technicolor Corporation with his cousin Cornelius Vanderbilt Whitney. By far Whitney's most famous investment was in Florida Foods Corporation. The company developed an innovative method for delivering nutrition to American soldiers, which later came to be known as Minute Maid orange juice and was sold to The Coca-Cola Company in 1960. J.H. Whitney & Company continues to make investments in leveraged buyout transactions and raised \$750 million for its sixth institutional private equity fund in 2005.

Early venture capital and the growth of Silicon Valley

One of the first steps toward a professionally-managed venture capital industry was the passage of the Small Business Investment Act of 1958. The 1958 Act officially allowed the U.S. Small Business Administration (SBA) to license private "Small Business Investment Companies" (SBICs) to help the financing and management of the small entrepreneurial businesses in the United States.^[11]

During the 1960s and 1970s, venture capital firms focused their investment activity primarily on starting and expanding companies. More often than not, these companies were exploiting breakthroughs in electronic, medical, or data-processing technology. As a result, venture capital came to be almost synonymous with technology finance. An early West Coast venture capital company was Draper and Johnson Investment Company, formed in 1962^[12] by William Henry Draper III and Franklin P. Johnson, Jr. In 1965, Sutter Hill Ventures acquired the portfolio of Draper and Johnson as a founding action. Bill Draper and Paul Wythes were the founders, and Pitch Johnson formed Asset Management Company at that time.

It is commonly noted that the first venture-backed startup is Fairchild Semiconductor (which produced the first commercially practical integrated circuit), funded in 1959 by what would later become Venrock Associates.^[13] Venrock was founded in 1969 by Laurance S. Rockefeller, the fourth of John D. Rockefeller's six children as a way to allow other Rockefeller children to develop exposure to venture capital investments.

It was also in the 1960s that the common form of private equity fund, still in use today, emerged. Private equity firms organized limited partnerships to hold investments in which the investment professionals served as general partner and the investors, who were passive limited partners, put up the capital. The compensation structure, still in use today, also emerged with limited partners paying an annual management fee of 1.0–2.5% and a carried interest



A highway exit for Sand Hill Road in Menlo Park, California, where many Bay Area venture capital firms are based

typically representing up to 20% of the profits of the partnership.

The growth of the venture capital industry was fueled by the emergence of the independent investment firms on Sand Hill Road, beginning with Kleiner, Perkins, Caufield & Byers and Sequoia Capital in 1972. Located in Menlo Park, CA, Kleiner Perkins, Sequoia and later venture capital firms would have access to the many semiconductor companies based in the Santa Clara Valley as well as early computer firms using their devices and programming and service companies.^[14]

Throughout the 1970s, a group of private equity firms, focused primarily on venture capital investments, would be founded that would become the model for later leveraged buyout and venture capital investment firms. In 1973, with the number of new venture capital firms increasing, leading venture capitalists formed the National Venture Capital Association (NVCA). The NVCA was to serve as the industry trade group for the venture capital industry.^[15]

Venture capital firms suffered a temporary downturn in 1974, when the stock market crashed and investors were naturally wary of this new kind of investment fund.

It was not until 1978 that venture capital experienced its first major fundraising year, as the industry raised approximately \$750 million. With the passage of the Employee Retirement Income Security Act (ERISA) in 1974, corporate pension funds were prohibited from holding certain risky investments including many investments in privately held companies. In 1978, the US Labor Department relaxed certain of the ERISA restrictions, under the "prudent man rule,"^[16] thus allowing corporate pension funds to invest in the asset class and providing a major source of capital available to venture capitalists.

1980s

The public successes of the venture capital industry in the 1970s and early 1980s (e.g., Digital Equipment Corporation, Apple Inc., Genentech) gave rise to a major proliferation of venture capital investment firms. From just a few dozen firms at the start of the decade, there were over 650 firms by the end of the 1980s, each searching for the next major "home run". The number of firms multiplied, and the capital managed by these firms increased from \$3 billion to \$31 billion over the course of the decade.^[17]

The growth of the industry was hampered by sharply declining returns, and certain venture firms began posting losses for the first time. In addition to the increased competition among firms, several other factors impacted returns. The market for initial public offerings cooled in the mid-1980s before collapsing after the stock market crash in 1987 and foreign corporations, particularly from Japan and Korea, flooded early stage companies with capital.^[17]

In response to the changing conditions, corporations that had sponsored in-house venture investment arms, including General Electric and Paine Webber either sold off or closed these venture capital units. Additionally, venture capital units within Chemical Bank and Continental Illinois National Bank, among others, began shifting their focus from funding early stage companies toward investments in more mature companies. Even industry founders J.H. Whitney & Company and Warburg Pincus began to transition toward leveraged buyouts and growth capital investments.^{[17][18][19]}

The venture capital boom and the Internet Bubble (1995 to 2000)

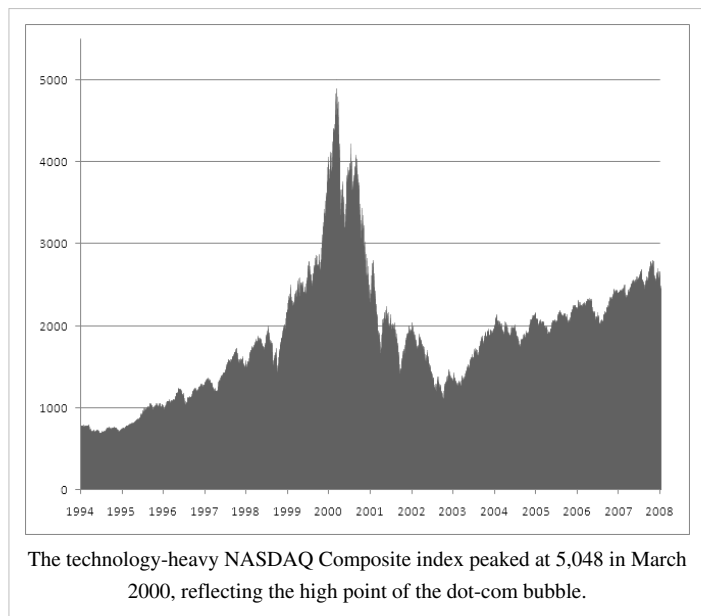
By the end of the 1980s, venture capital returns were relatively low, particularly in comparison with their emerging leveraged buyout cousins, due in part to the competition for hot startups, excess supply of IPOs and the inexperience of many venture capital fund managers. Growth in the venture capital industry remained limited throughout the 1980s and the first half of the 1990s, increasing from \$3 billion in 1983 to just over \$4 billion more than a decade later in 1994.

After a shakeout of venture capital managers, the more successful firms retrenched, focusing increasingly on improving operations at their portfolio companies rather than continuously making new investments. Results would begin to turn very attractive, successful and would ultimately generate the venture capital boom of the 1990s. Yale School of Management Professor Andrew Metrick refers to these first 15 years of the modern venture capital industry beginning in 1980 as the "pre-boom period" in anticipation of the boom that would begin in 1995 and last through the bursting of the Internet bubble in 2000.^[20]

The late 1990s were a boom time for venture capital, as firms on Sand Hill Road in Menlo Park and Silicon Valley benefited from a huge surge of interest in the nascent Internet and other computer technologies. Initial public offerings of stock for technology and other growth companies were in abundance, and venture firms were reaping large returns.

The private equity crash (2000 to 2003)

The Nasdaq crash and technology slump that started in March 2000 shook virtually the entire venture capital industry as valuations for startup technology companies collapsed. Over the next two years, many venture firms had been forced to write-off large proportions of their investments, and many funds were significantly "under water" (the values of the fund's investments were below the amount of capital invested). Venture capital investors sought to reduce size of commitments they had made to venture capital funds, and, in numerous instances, investors sought to unload existing commitments for cents on the dollar in the secondary market. By mid-2003, the venture capital industry had shriveled to about half its 2001 capacity. Nevertheless, PricewaterhouseCoopers's MoneyTree Survey^[21] shows that total venture capital investments held steady at 2003 levels through the second quarter of 2005.



Although the post-boom years represent just a small fraction of the peak levels of venture investment reached in 2000, they still represent an increase over the levels of investment from 1980 through 1995. As a percentage of GDP, venture investment was 0.058% in 1994, peaked at 1.087% (nearly 19 times the 1994 level) in 2000 and ranged from 0.164% to 0.182% in 2003 and 2004. The revival of an Internet-driven environment in 2004 through 2007 helped to revive the venture capital environment. However, as a percentage of the overall private equity market, venture capital has still not reached its mid-1990s level, let alone its peak in 2000.

Venture capital funds, which were responsible for much of the fundraising volume in 2000 (the height of the dot-com bubble), raised only \$25.1 billion in 2006, a 2%-decline from 2005 and a significant decline from its peak.^[22]

Funding

Obtaining venture capital is substantially different from raising debt or a loan from a lender. Lenders have a legal right to interest on a loan and repayment of the capital, irrespective of the success or failure of a business. Venture capital is invested in exchange for an equity stake in the business. As a shareholder, the venture capitalist's return is dependent on the growth and profitability of the business. This return is generally earned when the venture capitalist "exits" by selling its shareholdings when the business is sold to another owner.

Venture capitalists are typically very selective in deciding what to invest in; as a rule of thumb, a fund may invest in one in four hundred opportunities presented to it, looking for the extremely rare, yet sought after, qualities, such as innovative technology, potential for rapid growth, a well-developed business model, and an impressive management team. Of these qualities, funds are most interested in ventures with exceptionally high growth potential, as only such opportunities are likely capable of providing the financial returns and successful exit event within the required timeframe (typically 3–7 years) that venture capitalists expect.

Because investments are illiquid and require the extended timeframe to harvest, venture capitalists are expected to carry out detailed due diligence prior to investment. Venture capitalists also are expected to nurture the companies in which they invest, in order to increase the likelihood of reaching an IPO stage when valuations are favourable. Venture capitalists typically assist at four stages in the company's development:^[23]

- Idea generation;
- Start-up;
- Ramp up; and
- Exit

Because there are no public exchanges listing their securities, private companies meet venture capital firms and other private equity investors in several ways, including warm referrals from the investors' trusted sources and other business contacts; investor conferences and symposia; and summits where companies pitch directly to investor groups in face-to-face meetings, including a variant known as "Speed Venturing", which is akin to speed-dating for capital, where the investor decides within 10 minutes whether he wants a follow-up meeting. In addition, there are some new private online networks that are emerging to provide additional opportunities to meet investors.^[24]

This need for high returns makes venture funding an expensive capital source for companies, and most suitable for businesses having large up-front capital requirements, which cannot be financed by cheaper alternatives such as debt. That is most commonly the case for intangible assets such as software, and other intellectual property, whose value is unproven. In turn, this explains why venture capital is most prevalent in the fast-growing technology and life sciences or biotechnology fields.

If a company does have the qualities venture capitalists seek including a solid business plan, a good management team, investment and passion from the founders, a good potential to exit the investment before the end of their funding cycle, and target minimum returns in excess of 40% per year, it will find it easier to raise venture capital.

Financing stages

There are typically six stages of venture round financing offered in Venture Capital, that roughly correspond to these stages of a company's development.^[25]

- Seed funding: Low level financing needed to prove a new idea, often provided by angel investors. Crowd funding is also emerging as an option for seed funding.
 - Start-up: Early stage firms that need funding for expenses associated with marketing and product development
 - Growth (Series A round): Early sales and manufacturing funds
 - Second-Round: Working capital for early stage companies that are selling product, but not yet turning a profit
 - Expansion : Also called Mezzanine financing, this is expansion money for a newly profitable company
-

- Exit of venture capitalist : Also called bridge financing, 4th round is intended to finance the "going public" process

Between the first round and the fourth round, venture-backed companies may also seek to take venture debt.^[26]

Venture capital firms and funds

Venture capitalists

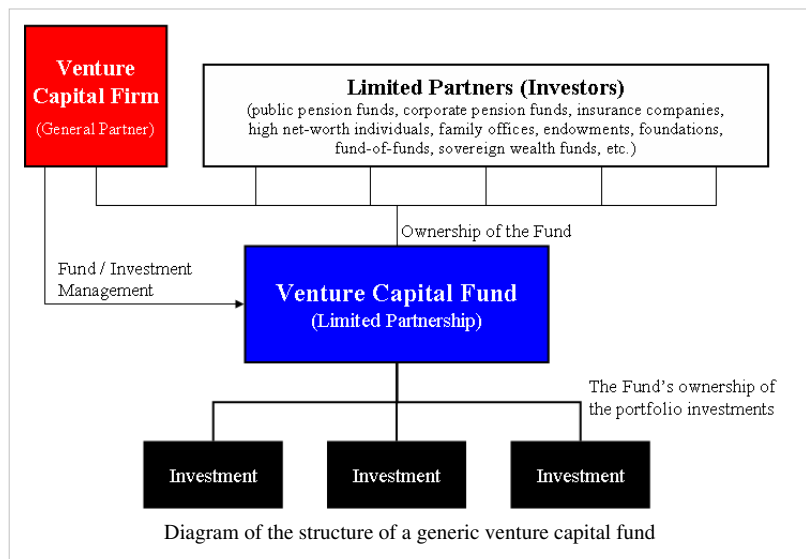
A venture capitalist is a person that makes venture investments, and these venture capitalists are expected to bring managerial and technical expertise as well as capital to their investments. A venture capital fund refers to a pooled investment vehicle (in the United States, often an LP or LLC) that primarily invests the financial capital of third-party investors in enterprises that are too risky for the standard capital markets or bank loans. These funds are typically managed by a venture capital firm, which often employs individuals with technology backgrounds (scientists, researchers), business training and/or deep industry experience.

A core skill within VC is the ability to identify novel technologies that have the potential to generate high commercial returns at an early stage. By definition, VCs also take a role in managing entrepreneurial companies at an early stage, thus adding skills as well as capital, thereby differentiating VC from buy-out private equity, which typically invest in companies with proven revenue, and thereby potentially realizing much higher rates of returns. Inherent in realizing abnormally high rates of returns is the risk of losing all of one's investment in a given startup company. As a consequence, most venture capital investments are done in a pool format, where several investors combine their investments into one large fund that invests in many different startup companies. By investing in the pool format, the investors are spreading out their risk to many different investments versus taking the chance of putting all of their money in one start up firm.

Structure

Venture capital firms are typically structured as partnerships, the general partners of which serve as the managers of the firm and will serve as investment advisors to the venture capital funds raised. Venture capital firms in the United States may also be structured as limited liability companies, in which case the firm's managers are known as managing members. Investors in venture capital funds are known as limited partners. This constituency comprises both high

net worth individuals and institutions with large amounts of available capital, such as state and private pension funds, university financial endowments, foundations, insurance companies, and pooled investment vehicles, called funds of funds.



Types

Venture Capitalist firms differ in their approaches. There are multiple factors, and each firm is different.^[27]

Some of the factors that influence VC decisions include:

- **Business situation:** Some VCs tend to invest in new ideas, or fledgling companies. Others prefer investing in established companies that need support to go public or grow.
- Some invest solely in certain industries.
- Some prefer operating locally while others will operate nationwide or even globally.
- VC expectations often vary. Some may want a quicker public sale of the company or expect fast growth. The amount of help a VC provides can vary from one firm to the next.

Roles

Within the venture capital industry, the general partners and other investment professionals of the venture capital firm are often referred to as "venture capitalists" or "VCs". Typical career backgrounds vary, but, broadly speaking, venture capitalists come from either an operational or a finance background. Venture capitalists with an operational background tend to be former founders or executives of companies similar to those which the partnership finances or will have served as management consultants. Venture capitalists with finance backgrounds tend to have investment banking or other corporate finance experience.

Although the titles are not entirely uniform from firm to firm, other positions at venture capital firms include:

- **Venture partners** — Venture partners are expected to source potential investment opportunities ("bring in deals") and typically are compensated only for those deals with which they are involved.
- **Principal** — This is a mid-level investment professional position, and often considered a "partner-track" position. Principals will have been promoted from a senior associate position or who have commensurate experience in another field, such as investment banking, management consulting, or a market of particular interest to the strategy of the venture capital firm.
- **Associate** — This is typically the most junior apprentice position within a venture capital firm. After a few successful years, an associate may move up to the "senior associate" position and potentially principal and beyond. Associates will often have worked for 1–2 years in another field, such as investment banking or management consulting.
- **Entrepreneur-in-residence (EIR)** — EIRs are experts in a particular domain and perform due diligence on potential deals. EIRs are engaged by venture capital firms temporarily (six to 18 months) and are expected to develop and pitch startup ideas to their host firm although neither party is bound to work with each other. Some EIRs move on to executive positions within a portfolio company.

Structure of the funds

Most venture capital funds have a fixed life of 10 years, with the possibility of a few years of extensions to allow for private companies still seeking liquidity. The investing cycle for most funds is generally three to five years, after which the focus is managing and making follow-on investments in an existing portfolio. This model was pioneered by successful funds in Silicon Valley through the 1980s to invest in technological trends broadly but only during their period of ascendance, and to cut exposure to management and marketing risks of any individual firm or its product.

In such a fund, the investors have a fixed commitment to the fund that is initially unfunded and subsequently "called down" by the venture capital fund over time as the fund makes its investments. There are substantial penalties for a limited partner (or investor) that fails to participate in a capital call.

It can take anywhere from a month or so to several years for venture capitalists to raise money from limited partners for their fund. At the time when all of the money has been raised, the fund is said to be closed, and the 10-year

lifetime begins. Some funds have partial closes when one half (or some other amount) of the fund has been raised. "Vintage year" generally refers to the year in which the fund was closed and may serve as a means to stratify VC funds for comparison. This^[28] shows the difference between a venture capital fund management company and the venture capital funds managed by them.

From investors' point of view, funds can be: (1) traditional--where all the investors invest with equal terms; or (2) asymmetric--where different investors have different terms. Typically the asymmetry is seen in cases where there's a investor that has other interests such as tax income in case of public investors.^[29]

Compensation

Venture capitalists are compensated through a combination of management fees and carried interest (often referred to as a "two and 20" arrangement):

- **Management fees** — an annual payment made by the investors in the fund to the fund's manager to pay for the private equity firm's investment operations.^[30] In a typical venture capital fund, the general partners receive an annual management fee equal to up to 2% of the committed capital.
- **Carried interest** — a share of the profits of the fund (typically 20%), paid to the private equity fund's management company as a performance incentive. The remaining 80% of the profits are paid to the fund's investors.^[30] Strong limited partner interest in top-tier venture firms has led to a general trend toward terms more favorable to the venture partnership, and certain groups are able to command carried interest of 25–30% on their funds.

Because a fund may run out of capital prior to the end of its life, larger venture capital firms usually have several overlapping funds at the same time; doing so lets the larger firm keep specialists in all stages of the development of firms almost constantly engaged. Smaller firms tend to thrive or fail with their initial industry contacts; by the time the fund cashes out, an entirely-new generation of technologies and people is ascending, whom the general partners may not know well, and so it is prudent to reassess and shift industries or personnel rather than attempt to simply invest more in the industry or people the partners already know.

Main alternatives to venture capital

Because of the strict requirements venture capitalists have for potential investments, many entrepreneurs seek seed funding from angel investors, who may be more willing to invest in highly speculative opportunities, or may have a prior relationship with the entrepreneur.

Furthermore, many venture capital firms will only seriously evaluate an investment in a start-up company otherwise unknown to them if the company can prove at least some of its claims about the technology and/or market potential for its product or services. To achieve this, or even just to avoid the dilutive effects of receiving funding before such claims are proven, many start-ups seek to self-finance sweat equity until they reach a point where they can credibly approach outside capital providers such as venture capitalists or angel investors. This practice is called "bootstrapping".

There has been some debate since the dot com boom that a "funding gap" has developed between the friends and family investments typically in the \$0 to \$250,000 range and the amounts that most VC funds prefer to invest between \$1 million to \$2 million. This funding gap may be accentuated by the fact that some successful VC funds have been drawn to raise ever-larger funds, requiring them to search for correspondingly larger investment opportunities. This gap is often filled by sweat equity and seed funding via angel investors as well as equity investment companies who specialize in investments in startup companies from the range of \$250,000 to \$1 million. The National Venture Capital Association estimates that the latter now invest more than \$30 billion a year in the USA in contrast to the \$20 billion a year invested by organized venture capital funds.

Crowd funding is emerging as an alternative to traditional venture capital. Crowd funding is an approach to raising the capital required for a new project or enterprise by appealing to large numbers of ordinary people for small donations. While such an approach has long precedents in the sphere of charity, it is receiving renewed attention from entrepreneurs such as independent film makers, now that social media and online communities make it possible to reach out to a group of potentially interested supporters at very low cost. Some crowd funding models are also being applied for startup funding such as those listed at Comparison of crowd funding services. One of the reasons to look for alternatives to venture capital is the problem of the traditional VC model. The traditional VCs are shifting their focus to later-stage investments, and return on investment of many VC funds have been low or negative.^{[24][31]}

In industries where assets can be securitized effectively because they reliably generate future revenue streams or have a good potential for resale in case of foreclosure, businesses may more cheaply be able to raise debt to finance their growth. Good examples would include asset-intensive extractive industries such as mining, or manufacturing industries. Offshore funding is provided via specialist venture capital trusts, which seek to utilise securitization in structuring hybrid multi-market transactions via an SPV (special purpose vehicle): a corporate entity that is designed solely for the purpose of the financing.

In addition to traditional venture capital and angel networks, groups have emerged, which allow groups of small investors or entrepreneurs themselves to compete in a privatized business plan competition where the group itself serves as the investor through a democratic process.^[32]

Law firms are also increasingly acting as an intermediary between clients seeking venture capital and the firms providing it.^[33]

Geographical differences

Venture capital, as an industry, has originated in the United States, and American firms have traditionally been the largest participants in venture deals, and the bulk of venture capital has been deployed in American companies. However, increasingly, non-US venture investment is growing, and the number and size of non-US venture capitalists have been expanding.

Venture capital has been used as a tool for economic development in a variety of developing regions. In many of these regions, with less developed financial sectors, venture capital plays a role in facilitating access to finance for small and medium enterprises (SMEs), which in most cases would not qualify for receiving bank loans.

In the year of 2008, while VC fundings were still majorly dominated by U.S. money (\$28.8 billion invested in over 2550 deals in 2008), compared to international fund investments (\$13.4 billion invested elsewhere), there has been an average 5% growth in the venture capital deals outside the USA, mainly in China and Europe.^[34] Geographical differences can be significant. For instance, in the U.K., 4% of British investment goes to venture capital, compared to about 33% in the U.S.^[35]

United States

Venture capitalists invested some \$29.1 billion in 3,752 deals in the U.S. through the fourth quarter of 2011, according to a report by the National Venture Capital Association^[36]. The same numbers for all of 2010 were \$23.4 billion in 3,496 deals.^[37] A National Venture Capital Association survey found that a majority (69%) of venture capitalists predicted that venture investments in the U.S. would have leveled between \$20–29 billion in 2007.

Mexico

The Venture Capital industry in Mexico, is a fast growing sector in the country that, with the support of institutions and private funds, is estimated to reach one trillion dollar investment in 2018.^[38]

Israel

As of 2010, Israel led the world in venture capital invested per capita. Israel attracted \$170 per person compared to \$75 in the USA.^[39] About two thirds of the funds invested were from foreign sources, and the rest domestic.

Canada

Canadian technology companies have attracted interest from the global venture capital community as a result, in part, of generous tax incentive through the Scientific Research and Experimental Development (SR&ED) investment tax credit program. The basic incentive available to any Canadian corporation performing R&D is a refundable tax credit that is equal to 20% of "qualifying" R&D expenditures (labour, material, R&D contracts, and R&D equipment). An enhanced 35% refundable tax credit of available to certain (i.e. small) Canadian-controlled private corporations (CCPCs). Because the CCPC rules require a minimum of 50% Canadian ownership in the company performing R&D, foreign investors who would like to benefit from the larger 35% tax credit must accept minority position in the company, which might not be desirable. The SR&ED program does not restrict the export of any technology or intellectual property that may have been developed with the benefit of SR&ED tax incentives.

Canada also has a fairly unique form of venture capital generation in its Labour Sponsored Venture Capital Corporations (LSVCC). These funds, also known as Retail Venture Capital or Labour Sponsored Investment Funds (LSIF), are generally sponsored by labor unions and offer tax breaks from government to encourage retail investors to purchase the funds. Generally, these Retail Venture Capital funds only invest in companies where the majority of employees are in Canada. However, innovative structures have been developed to permit LSVCCs to direct in Canadian subsidiaries of corporations incorporated in jurisdictions outside of Canada.

Europe

Europe has a large and growing number of active venture firms. Capital raised in the region in 2005, including buy-out funds, exceeded €60 billion, of which €12.6 billion was specifically allocated to venture investment. The European Venture Capital Association^[40] includes a list of active firms and other statistics. In 2006, the top three countries receiving the most venture capital investments were the United Kingdom (515 minority stakes sold for €1.78 billion), France (195 deals worth €875 million), and Germany (207 deals worth €428 million) according to data gathered by Library House.^[41]

European venture capital investment in the second quarter of 2007 rose 5% to €1.14 billion from the first quarter. However, due to bigger sized deals in early stage investments, the number of deals was down 20% to 213. The second quarter venture capital investment results were significant in terms of early-round investment, where as much as €600 million (about 42.8% of the total capital) were invested in 126 early round deals (which comprised more than half of the total number of deals).^[42] Private equity in Italy was 4.2 billion Euros in 2007.

A study published in early 2013 showed that contrary to popular belief, European startups backed by venture capital do not perform worse than US counterparts^[43]. European venture backed firms have an equal chance of listing on the stock exchange, and a slightly lower chance of a "trade sale" (acquisition by other company).

Asia

- India is fast catching up with the West in the field of venture capital and a number of venture capital funds have a presence in the country (IVCA). In 2006, the total amount of private equity and venture capital in India reached \$7.5 billion across 299 deals.^[44] In the Indian context, venture capital consists of investing in equity, quasi-equity, or conditional loans in order to promote unlisted, high-risk, or high-tech firms driven by technically or professionally qualified entrepreneurs. It is also defined as "providing seed", "start-up and first-stage financing".^[45] It is also seen as financing companies that have demonstrated extraordinary business potential. Venture capital refers to capital investment; equity and debt ;both of which carry indubitable risk. The risk anticipated is very high. The venture capital industry follows the concept of "high risk, high return", innovative

entrepreneurship, knowledge-based ideas and human capital intensive enterprises have taken the front seat as venture capitalists invest in risky finance to encourage innovation.^[46]

- China is also starting to develop a venture capital industry (CVCA).
- Vietnam is experiencing its first foreign venture capitals, including IDG Venture Vietnam (\$100 million) and DFJ Vinacapital (\$35 million)^[47]

Middle East and North Africa

The Middle East and North Africa (MENA) venture capital industry is an early stage of development but growing. The MENA Private Equity Association^[48] Guide to Venture Capital^[49] for entrepreneurs lists VC firms in the region, and other resources available in the MENA VC ecosystem.

Southern Africa

The Southern African venture capital industry is an early stage of development, mostly centered in South Africa. Funds are difficult to come by and very few firms have managed to get fundings despite demonstrating tremendous growth potential. Generally the climate for the venture capital industry is poor.

Confidential information

Unlike public companies, information regarding an entrepreneur's business is typically confidential and proprietary. As part of the due diligence process, most venture capitalists will require significant detail with respect to a company's business plan. Entrepreneurs must remain vigilant about sharing information with venture capitalists that are investors in their competitors. Most venture capitalists treat information confidentially, but as a matter of business practice, they do not typically enter into Non Disclosure Agreements because of the potential liability issues those agreements entail. Entrepreneurs are typically well-advised to protect truly proprietary intellectual property.

Limited partners of venture capital firms typically have access only to limited amounts of information with respect to the individual portfolio companies in which they are invested and are typically bound by confidentiality provisions in the fund's limited partnership agreement.

Popular culture

- Robert von Goeben and Kathryn Siegler produced a comic strip called *The VC* between the years 1997-2000 that parodied the industry, often by showing humorous exchanges between venture capitalists and entrepreneurs.^[50] Von Goeben was a partner in Redleaf Venture Management when he began writing the strip.^[51]
- Mark Coggins' 2002 novel *Vulture Capital* features a venture capitalist protagonist who investigates the disappearance of the chief scientist in a biotech firm in which he has invested. Coggins also worked in the industry and was co-founder of a dot-com startup.^[52]
- In the Dilbert comic strip, a character named 'Vijay, the World's Most Desperate Venture Capitalist' frequently makes appearances, offering bags of cash to anyone with even a hint of potential. In one strip, he offers two small children with good math grades money based on the fact that if they marry and produce an engineer baby he can invest in the infant's first idea. The children respond that they are already looking for mezzanine funding.
- Drawing on his experience as reporter covering technology for the *New York Times*, Matt Richtel produced the 2007 novel *Hooked*, in which the actions of the main character's deceased girlfriend, a Silicon Valley venture capitalist, play a key role in the plot.^[53]
- In the TV series *Dragons' Den*, various startup companies pitch their business plans to a panel of venture capitalists.

- In the 2005 movie, *Wedding Crashers*, Jeremy Grey (Vince Vaughn) and John Beckwith (Owen Wilson) are two bachelors who create appearances to play at different weddings of complete strangers, and a large part of the movie follows them posing as venture capitalists from New Hampshire.
- A documentary, *Something Ventured*, chronicled the recent history of American technology venture capitalists.
- In the ABC Reality Show "Shark Tank", in which Venture Capitalists ("Sharks") invest in Entrepreneurs.

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Venture capital financing

Venture capital financing is a type of financing by venture capital: the type of private equity capital is provided as seed funding to early-stage, high-potential, growth companies and more often after the seed funding round as growth funding round (also referred as series A round) in the interest of generating a return through an eventual realization event such as an IPO or trade sale of the company.

Overview

To start a new startup company or to bring a new product to the market, the venture needs to attract funding. There are several categories of financing possibilities. Smaller ventures sometimes rely on family funding, loans from friends, personal bank loans or crowd funding.

More ambitious projects that need more substantial funding may turn to angel investors - private investors who use their own capital to finance a ventures' need, or Venture Capital (VC) companies that specialize in financing new ventures. VC firms may also provide expertise the venture is lacking, such as legal or marketing knowledge.

Venture capital financing process

There are five common stages of venture capital financing:

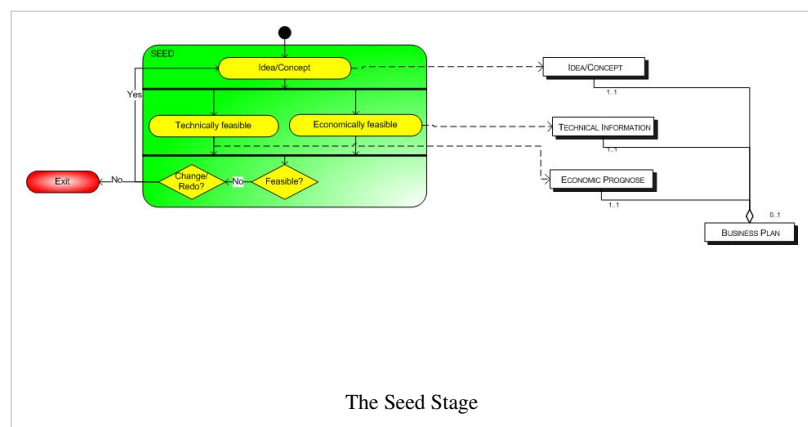
1. The Seed stage
2. The Start-up stage
3. The Second stage
4. The Third stage
5. The Bridge/Pre-public stage

The number and type of stages may be extended by the VC firm if it deems necessary; this is common. This may happen if the venture does not perform as expected due to bad management or market conditions (see: Dot com boom).

The following schematics shown here are called the process data models. All activities that find place in the venture capital financing process are displayed at the left side of the model. Each box stands for a stage of the process and each stage has a number of activities. At the right side, there are concepts. Concepts are visible products/data gathered at each activity. This diagram is according to the modeling technique founded by Professor Sjaak Brinkkemper of the University of Utrecht in the Netherlands.

The Seed Stage

This is where the seed funding takes place. It is considered as the setup stage where a person or a venture approaches an angel investor or an investor in a VC firm for funding for their idea/product. During this stage, the person or venture has to convince the investor why the idea/product is worthwhile. The investor will investigate into the technical and the



economical feasibility (Feasibility Study) of the idea. In some cases, there is some sort of prototype of the idea/product that is not fully developed or tested.

If the idea is not feasible at this stage, and the investor does not see any potential in the idea/product, the investor will not consider financing the idea. However if the idea/product is not directly feasible, but part of the idea is worth for more investigation, the investor may invest some time and money in it for further investigation.

Example

A Dutch venture named High 5 Business Solution V.O.F. wants to develop a portal which allows companies to order lunch. To open this portal, the venture needs some financial resources, they also need marketeers and market researchers to investigate whether there is a market for their idea. To attract these financial and non-financial resources, the executives of the venture decide to approach ABN AMRO Bank to see if the bank is interested in their idea.

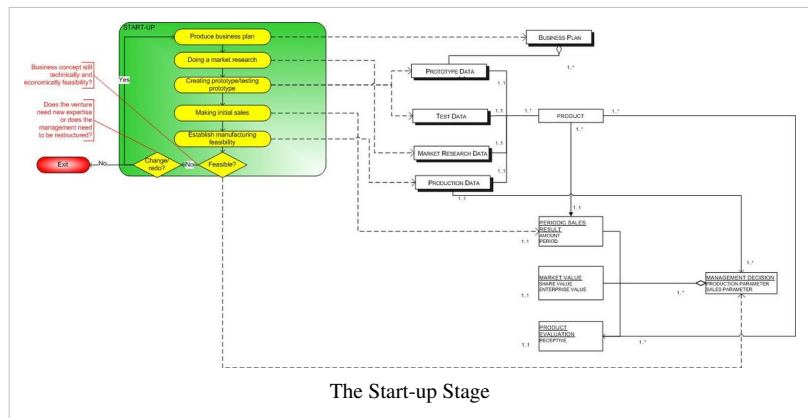
After a few meetings, the executives are successful in convincing the bank to take a look in the feasibility of the idea. ABN AMRO decides to put a few experts for investigation. After two weeks time, the bank decides to invest. They come to an agreement of invest a small amount of money into the venture. The bank also decides to provide a small team of marketeers and market researchers and a supervisor. This is done to help the venture with the realization of their idea and to monitor the activities in the venture.

Risk

At this stage, the risk of losing the investment is tremendously high, because there are so many uncertain factors. Research by J.C. Ruhnka and J.E. Young shows that the risk of losing the investment for the VC firm is around 66.2% and the causation of major risk by stage of development is 72% . The Harvard report^[1] by William R. Kerr, Josh Lerner, and Antoinette Schoar, however, shows evidence that angel-funded startup companies are less likely to fail than companies that rely on other forms of initial financing.

The Start-up Stage

If the idea/product/process is qualified for further investigation and/or investment, the process will go to the second stage; this is also called the start-up stage. At this point many exciting things happen. A business plan is presented by the attendant of the venture to the VC firm. A management team is being formed to run the venture. If the company has a board of directors, a person from the VC firms will take seats at the board of directors.



While the organisation is being set up, the idea/product gets its form. The prototype is being developed and fully tested. In some cases, clients are being attracted for initial sales. The management-team establishes a feasible production line to produce the product. The VC firm monitors the feasibility of the product and the capability of the management-team from the board of directors.

To prove that the assumptions of the investors are correct about the investment, the VC firm wants to see result of market research to see whether the market size is big enough, if there are enough consumers to buy their product. They also want to create a realistic forecast of the investment needed to push the venture into the next stage. If at this stage, the VC firm is not satisfied about the progress or result from market research, the VC firm may stop their

funding and the venture will have to search for another investor(s). When the cause relies on handling of the management in charge, they will recommend replacing (parts of) the management team.

Example

Now the venture has attracted an investor, the venture needs to satisfy the investor for further investment. To do that, the venture needs to provide the investor a clear business plan how to realise their idea and how the venture is planning to earn back the investment that is put into the venture, of course with a lucrative return.

Together with the market researchers, provided by the investor, the venture has to determine how big the market is in their region. They have to find out who are the potential clients and if the market is big enough to realise the idea.

From market research, the venture comes to know that there are enough potential clients for their portal site. But there are no providers of lunches yet. To convince these providers, the venture decided to do interviews with providers and try to convince them to join.

With this knowledge, the venture can finish their business plan and determine a pretty good forecast of the revenue, the cost of developing and maintaining the site and the profit the venture will earn in the following five years.

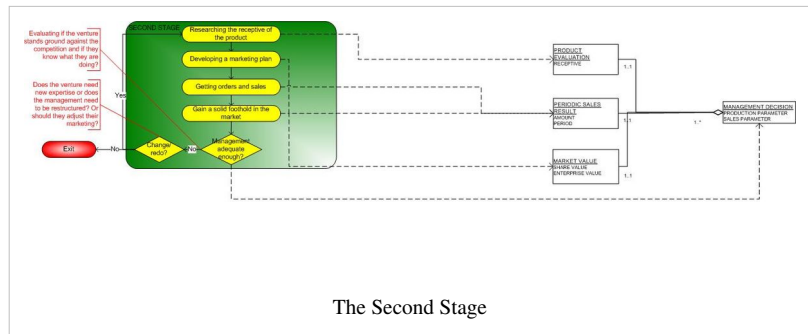
After reading the business plan and consulting the person who monitors the venture activities, the investor decides that the idea is worth for further development.

Risk

At this stage, the risk of losing the investment is shrinking, because the uncertainty is becoming clearer. The risk of losing the investment for the VC firm is dropped to 53.0%, but the causation of major risk by stage of development becomes higher, which is 75.8%. This can be explained by the fact because the prototype was not fully developed and tested at the seed stage. And the VC firm has underestimated the risk involved. Or it could be that the product and the purpose of the product have been changed during the development.^[2]

The Second Stage

At this stage, we presume that the idea has been transformed into a product and is being produced and sold. This is the first encounter with the rest of the market, the competitors. The venture is trying to squeeze between the rest and it tries to get some market share from the competitors. This is one of the main goals at this stage. Another important point is the cost. The venture is trying to minimize their losses in order to reach the break-even.



The management team has to handle very decisively. The VC firm monitors the management capability of the team. This consists of how the management team manages the development process of the product and how they react to competition.

If at this stage the management team is proven their capability of standing hold against the competition, the VC firm will probably give a go for the next stage. However, if the management team lacks in managing the company or does not succeed in competing with the competitors, the VC firm may suggest for restructuring of the management team and extend the stage by redoing the stage again. In case the venture is doing tremendously bad whether it is caused by the management team or from competition, the venture will cut the funding.

Example

The portal site needs to be developed. (If possible, the development should be taken place in house. If not, the venture needs to find a reliable designer to develop the site.) Developing the site in house is not possible; the venture does not have this knowledge in house. The venture decides to consult this with the investor. After a few meetings, the investor decides to provide the venture a small team of web-designers. The investor also has given the venture a deadline when the portal should be operational. The deadline is in three months.

In the meantime, the venture needs to produce a client portfolio, who will provide their menu at the launch of the portal site. The venture also needs to come to an agreement on how these providers are being promoted at the portal site and against what price.

After three months, the investor requests the status of development. Unfortunately for the venture, the development did not go as planned. The venture did not make the deadline. According to the one who is monitoring the activities, this is caused by the lack of decisiveness by the venture and the lack of skills of the designers.

The investor decides to cut back their financial investment after a long meeting. The venture is given another three months to come up with an operational portal site. Three designers are being replaced by a new designer and a consultant is attracted to support the executives' decisions. If the venture does not make this deadline in time, they have to find another investor.

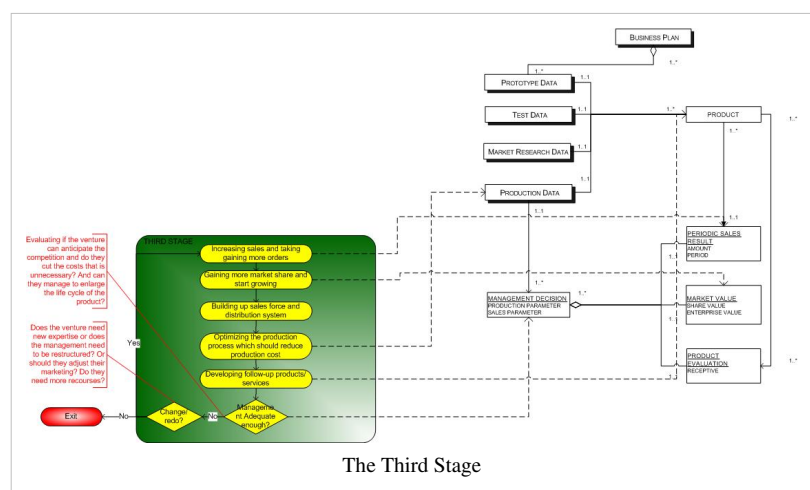
Luckily for the venture, with the come of the new designer and the consultant, the venture succeeds in making the deadline. They even have two weeks left before the second deadline ends.

Risk

At this stage, the risk of losing the investment still drops, because the venture is capable to estimate the risk. The risk of losing the investment for the VC firm drops from 53.0% to 33.7%, and the causation of major risk by stage of development also drops at this stage, from 75.8% to 53.0%. This can be explained by the fact that there is not much developing going on at this stage. The venture is concentrated in promoting and selling the product. That is why the risk decreases.^[3]

The Third Stage

This stage is seen as the expansion/maturity phase of the previous stage. The venture tries to expand the market share they gained in the previous stage. This can be done by selling more amount of the product and having a good marketing campaign. Also, the venture will have to see whether it is possible to cut down their production cost or restructure the internal process. This can become more visible by doing a SWOT analysis. It is used to figure out the strength, weakness, opportunity and the threat the venture is facing and how to deal with it.



Except that the venture is expanding, the venture also starts to investigate follow-up products and services. In some cases, the venture also investigates how to expand the life-cycle of the existing product/service.

At this stage the VC firm monitors the objectives already mentioned in the second stage and also the new objective mentioned at this stage. The VC firm will evaluate if the management team has made the expected reduction cost.

They also want to know how the venture competes against the competitors. The new developed follow-up product will be evaluated to see if there is any potential.

Example

Finally the portal site is operational. The portal is getting more orders from the working class every day. To keep this going, the venture needs to promote their portal site. The venture decides to advertise by distributing flyers at each office in their region to attract new clients.

In the meanwhile, a small team is being assembled for sales, which will be responsible for getting new lunchrooms/bakeries, any eating-places in other cities/region to join the portal site. This way the venture also works on expanding their market.

Because of the delay at the previous stage, the venture did not fulfil the expected target. From a new forecast, requested by the investor, the venture expects to fulfil the target in the next quarter or the next half year. This is caused by external issues the venture does not have control of it. The venture has already suggested to stabilise the existing market the venture already owns and to decrease the promotion by 20% of what the venture is spending at the moment. This is approved by the investor.

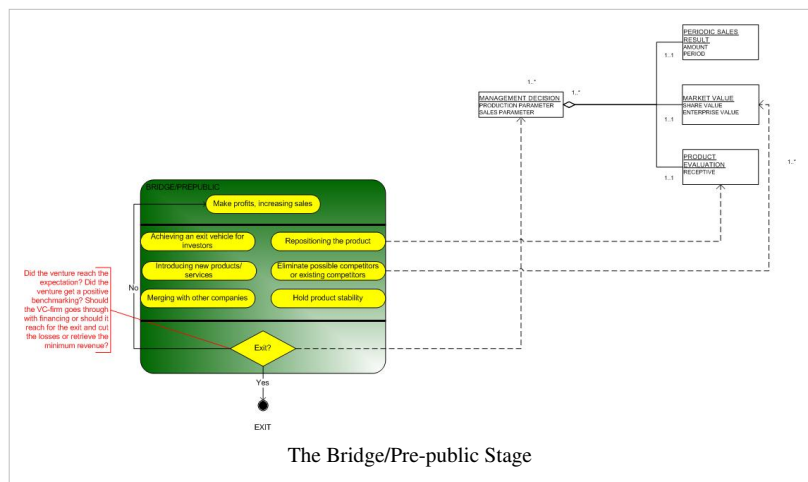
Risk

At this stage, the risk of losing the investment for the VC firm drops with 13.6% to 20.1%, and the causation of major risk by stage of development drops almost by half from 53.0% to 37.0%. However at this stage it happens often that new follow-up products are being developed. The risk of losing the investment is still decreasing. This may be because the venture rely its income on the existing product. That is why the percentage continuous drop.^[4]

The Bridge/Pre-public Stage

In general this stage is the last stage of the venture capital financing process. The main goal of this stage is to achieve an exit vehicle for the investors and for the venture to go public. At this stage the venture achieves a certain amount of the market share. This gives the venture some opportunities; for example:

- Merger with other companies
- Keeping away new competitors from approaching the market
- Eliminate competitors



Internally, the venture has to reposition the product and see where the product is positioned and if it is possible to attract new Market segmentation. This is also the phase to introduce the follow-up product/services to attract new clients and markets.

As we already mentioned, this is the final stage of the process. But most of the time, there will be an additional continuation stage involved between the third stage and the Bridge/pre-public stage. However there are limited circumstances known where investors made a very successful initial market impact might be able to move from the third stage directly to the exit stage. Most of the time the venture fails to achieves some of the important benchmarks the VC firms aimed.

Example

Now the site is running smoothly, the venture is thinking about taking over the competitors' website happen.nl. The site is promoting restaurants and is also doing business in online ordering food. This proposal is being protested by the investor, because it may cost a lot of the ventures' capital. The investor suggests a merge instead.

To settle down their differences, the venture requested an external party to investigate into the case. The result of the investigation was a take-over. After reading the investigation, the investor agrees to it and happen.nl is being taken over by the venture. With the take-over of a competitor, the venture has expanded its services.

Seeing the ventures' result, the investor comes to the conclusion that the venture still have not reach the target that was expected, but seeing how the business is progressing, the investor decides to extend its investment for another year.

Risk

At this final stage, the risk of losing the investment still exists. However, compared with the numbers mentioned at the seed-stage it is far lower. The risk of losing the investment the final stage is a little higher at 20.9%. This is caused by the number of times the VC firms may want to expand the financing cycle, not to mention that the VC firm is faced with the dilemma of whether to continuously invest or not. The causation of major risk by this stage of development is 33%. This is caused by the follow-up product that is introduced.^[5]

At Last

As mentioned in the first paragraph, a VC firm is not only about funding and lucrative returns, but it also offers knowledge support. Also, as can be seen below, the amount of risk (of losing investment value) decreases with each additional funding stage

Stage at which investment made	Risk of loss	Causation of major risk by stage of development
The Seed-stage	66.2%	72.0%
The Start-up Stage	53.0%	75.8%
The Second Stage	33.7%	53.0%
The Third Stage	20.1%	37.0%
The Bridge/Pre-public Stage	20.9%	33.0%

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Further reading

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Seed money

Seed money, sometimes known as **seed funding**, is a form of securities offering in which an investor purchases part of a business. The term *seed* suggests that this is an early investment, meant to support the business until it can generate cash of its own, or until it is ready for further investments. Seed money options include **friends and family funding**, **angel funding** and -- recently -- crowd funding.

Usage

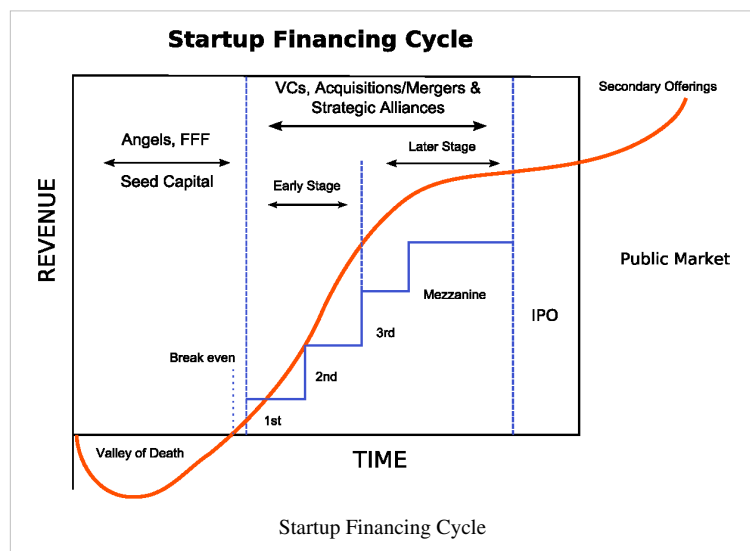
Seed money can be used to pay for such preliminary operations as market research and product development. Investors can be the founders themselves, using savings and loans. They can be family members and friends of the founders. Investors can also be outside angel investors, venture capitalists or accredited investors. Seed capital is not necessarily a large amount of money. Many people start up new business ventures with \$50,000 or less.

Seed capital can be distinguished from venture capital in that venture capital investments tend to involve significantly

more money, an arm's length transaction, and much greater complexity in the contracts and corporate structure that accompany the investment. Seed funding involves a higher risk than normal venture capital funding since the investor does not see any existing project to evaluate for funding. Hence the investments made are usually lower (in the tens of thousands to the hundreds of thousands of dollars range) as against normal venture capital investment (in the hundreds of thousands to the millions of dollars range), for similar levels of stake in the company.

Seed money may also come from crowd funding or from financial bootstrapping rather than an equity offering. Bootstrapping in this context means making use of the cash flow of an existing enterprise.

Investors make their decision whether to fund a project based on the perceived strength of the idea and the capabilities, skills and history of the founders.



References

External links

- Seed investment company etventure (based in Germany) (<http://www.etventure.com>)

Rate of return

In finance, **rate of return (ROR)**, also known as **return on investment (ROI)**, **rate of profit** or sometimes just **return**, is the ratio of money gained or lost (whether realized or unrealized) on an investment relative to the amount of money invested. The amount of money gained or lost may be referred to as interest, profit/loss, gain/loss, or net income/loss. The money invested may be referred to as the asset, capital, principal, or the cost basis of the investment. ROI is usually expressed as a percentage.

Calculation

The initial value of an investment, V_i , does not always have a clearly defined monetary value, but for purposes of measuring ROI, *the expected value must be clearly stated* along with the rationale for this initial value. Similarly, the final value of an investment, V_f , also does not always have a clearly defined monetary value, but for purposes of measuring ROI, *the final value must be clearly stated* along with the rationale for this final value.

The rate of return can be calculated over a single period, or expressed as an average over multiple periods of time.

Single-period

Arithmetic return

The **arithmetic return** is:

$$r_{arith} = \frac{V_f - V_i}{V_i}$$

r_{arith} is sometimes referred to as the **yield**. See also: effective interest rate, effective annual rate (EAR) or annual percentage yield (APY).

Logarithmic or continuously compounded return

The **logarithmic return** or **continuously compounded return**, also known as force of interest, is defined as:

$$r_{log} = \frac{\ln\left(\frac{V_f}{V_i}\right)}{t}$$

or

$$R = Pe^{rt}$$

where: R = Returns P = Principal amount r = rate t = time period

Multiperiod average returns

Arithmetic average rate of return

The **arithmetic average rate of return** over n periods is defined as:

$$\bar{r}_{arithmetic} = \frac{1}{n} \sum_{i=1}^n r_{arith,i} = \frac{1}{n} (r_{arith,1} + \dots + r_{arith,n})$$

Geometric average rate of return

The **geometric average rate of return**, also known as the **annualized return**, over n periods is defined as:

$$\bar{r}_{geometric} = \left(\prod_{i=1}^n (1 + r_{arith,i}) \right)^{1/n} - 1$$

Importantly, the annualized return is *less* than the average annual return (or equal if all annual returns are equal), as a consequence of the AM–GM inequality. In fact, the difference between the annualized return and average annual return is proportional to variance (square root of volatility) – the more volatile the performance, the greater the difference, in proportion to the variance.^[1] As a basic example, a return of +10%, followed by –10%, has an average return of 0%, but the overall result is $110\% \times 90\% = 99\%$ for an overall return of –1%. For a return of +20%, followed by –20%, this again has an average return of 0%, but an overall return of –4%. In the extreme, a return of +100%, followed by –100%, has an average return of 0%, but an overall return of –100%, as the value ends at 0. In cases of leveraged investments, even more extreme results are possible: a return of +200%, followed by –200%, has an average return of 0%, but an overall return of –300%. In financial mathematics, the infinitesimal version of this discrepancy between the average return and the annualized return, meaning when the year-long periods are replaced by shorter periods (in the limit infinitely short periods), is Itô's lemma for geometric Brownian motion.

In the presence of external flows, such as cash or securities moving into or out of the portfolio, the overall return must be calculated gross of these movements, which is done by the *True Time-Weighted Rate of Return* (TWRR). Time-weighted rates of return are important because they eliminate the impact of cash flows. This is helpful when assessing the job that a money manager did for his/her clients, where typically the clients control these cash flows.^[2]

Internal rate of return

The **internal rate of return** (IRR), also known as the **dollar-weighted rate of return** or the **money-weighted rate of return** (MWRR), is defined as the value(s) of \bar{r} that satisfies the following equation:

$$NPV = \sum_{t=0}^n \frac{C_t}{(1 + \bar{r})^t} = 0$$

where:

- NPV = net present value of the investment
- C_t = cashflow at time t

When the cost of capital r is smaller than the IRR rate \bar{r} , the investment is profitable, i.e., $NPV > 0$. Otherwise, the investment is not profitable.

MWRR are helpful in that they take cash flows into consideration. This is especially helpful when evaluating cases where the money manager controls cash flows (for private equity investments, for example, as well as sub-portfolio rates of return) as well as to provide the investor with their return. Contrast with TWRR.

Comparisons between various rates of return

Arithmetic and logarithmic return

The value of an investment is doubled over a year if the annual ROR $r_{arith} = +100\%$, that is, if $r_{log} = \ln(\$200 / \$100) = \ln(2) = 69.3\%$. The value falls to zero when $r_{arith} = -100\%$, that is, if $r_{log} = -\infty$.

Arithmetic and logarithmic returns are not equal, but are approximately equal for small returns. The difference between them is large only when percent changes are high. For example, an arithmetic return of $+50\%$ is equivalent to a logarithmic return of 40.55% , while an arithmetic return of -50% is equivalent to a logarithmic return of -69.31% .

Logarithmic returns are often used by academics in their research. The main advantage is that the continuously compounded return is symmetric, while the arithmetic return is not: positive and negative percent arithmetic returns are not equal. This means that an investment of \$100 that yields an arithmetic return of 50% followed by an arithmetic return of -50% will result in \$75, while an investment of \$100 that yields a logarithmic return of 50% followed by a logarithmic return of -50% it will remain \$100.

Comparison of arithmetic and logarithmic returns for initial investment of \$100

Initial investment, V_i	\$100	\$100	\$100	\$100	\$100
Final investment, V_f	\$0	\$50	\$100	\$150	\$200
Profit/loss, $V_f - V_i$	-\$100	-\$50	\$0	\$50	\$100
Arithmetic return, r_{arith}	-100%	-50%	0%	50%	100%
Logarithmic return, r_{log}	$-\infty$	-69.31%	0%	40.55%	69.31%

Arithmetic average and geometric average rates of return

Both arithmetic and geometric average rates of returns are averages of periodic percentage returns. Neither will accurately translate to the actual dollar amounts gained or lost if percent gains are averaged with percent losses.^[3] A 10% loss on a \$100 investment is a \$10 loss, and a 10% gain on a \$100 investment is a \$10 gain. When percentage returns on investments are calculated, they are calculated for a period of time – not based on original investment dollars, but based on the dollars in the investment at the beginning and end of the period. So if an investment of \$100 loses 10% in the first period, the investment amount is then \$90. If the investment then gains 10% in the next period, the investment amount is \$99.

A 10% gain followed by a 10% loss is a 1% loss. The order in which the loss and gain occurs does not affect the result. A 50% gain and a 50% loss is a 25% loss. An 80% gain plus an 80% loss is a 64% loss. To recover from a 50% loss, a 100% gain is required. The mathematics of this are beyond the scope of this article, but since investment returns are often published as "average returns", it is important to note that average returns do not always translate into dollar returns.

Example #1 Level Rates of Return

	Year 1	Year 2	Year 3	Year 4
Rate of Return	5%	5%	5%	5%
Geometric Average at End of Year	5%	5%	5%	5%
Capital at End of Year	\$105.00	\$110.25	\$115.76	\$121.55
Dollar Profit/(Loss)	\$5.00	\$10.25	\$15.76	\$21.55
Compound Yield	5%			5.4%

Example #2 Volatile Rates of Return, including losses

	Year 1	Year 2	Year 3	Year 4
Rate of Return	50%	-20%	30%	-40%
Geometric Average at End of Year	50%	9.5%	16%	-1.6%
Capital at End of Year	\$150.00	\$120.00	\$156.00	\$93.60
Dollar Profit/(Loss)				(\$6.40)
Compound Yield				-1.6%

Example #3 Highly Volatile Rates of Return, including losses

	Year 1	Year 2	Year 3	Year 4
Rate of Return	-95%	0%	0%	115%
Geometric Average at End of Year	-95%	-77.6%	-63.2%	-42.7%
Capital at End of Year	\$5.00	\$5.00	\$5.00	\$10.75
Dollar Profit/(Loss)				(\$89.25)
Compound Yield				-22.3%

Annual returns and annualized returns

Care must be taken not to confuse annual and annualized returns. An annual rate of return is a single-period return, while an annualized rate of return is a multi-period, arithmetic average return.

An annual rate of return is the return on an investment over a one-year period, such as January 1 through December 31, or June 3, 2006 through June 2, 2007. Each ROI in the cash flow example above is an annual rate of return.

An annualized rate of return is the return on an investment over a period other than one year (such as a month, or two years) multiplied or divided to give a comparable one-year return. For instance, a one-month ROI of 1% could be stated as an annualized rate of return of $12.7\% = ((1+0.01)^{12} - 1)$. Or a two-year ROI of 10% could be stated as an annualized rate of return of $4.88\% = ((1+0.1)^{(12/24)} - 1)$.

In the cash flow example below, the dollar returns for the four years add up to \$265. The annualized rate of return for the four years is: $\$265 \div (\$1,000 \times 4 \text{ years}) = 6.625\%$.

Uses

- ROI is a measure of cash generated by or lost due to the investment. It measures the cash flow or income stream from the investment to the investor, relative to the amount invested. Cash flow to the investor can be in the form of profit, interest, dividends, or capital gain/loss. Capital gain/loss occurs when the market value or resale value of the investment increases or decreases. Cash flow here does not include the return of invested capital.

Cash Flow Example on \$1,000 Investment

	Year 1	Year 2	Year 3	Year 4
Dollar Return	\$100	\$55	\$60	\$50
ROI	10%	5.5%	6%	5%

- ROI values typically used for **personal financial decisions** include Annual Rate of Return and Annualized Rate of Return. For nominal risk investments such as savings accounts or Certificates of Deposit, the personal investor considers the effects of reinvesting/compounding on increasing savings balances over time. For investments in which capital is at risk, such as stock shares, mutual fund shares and home purchases, the personal investor considers the effects of price volatility and capital gain/loss on returns.
- Profitability ratios typically used by financial analysts to **compare a company's profitability over time or compare profitability between companies** include Gross Profit Margin, Operating Profit Margin, ROI ratio, Dividend yield, Net profit margin, Return on equity, and Return on assets.^[4]
- During capital budgeting, companies compare the rates of return of different projects to select which projects to pursue in order to generate maximum return or wealth for the company's stockholders. Companies do so by considering the average rate of return, payback period, net present value, profitability index, and internal rate of return for various projects.^[5]
- A return may be adjusted for taxes to give the after-tax rate of return. This is done in geographical areas or historical times in which taxes consumed or consume a significant portion of profits or income. The after-tax rate of return is calculated by multiplying the rate of return by the tax rate, then subtracting that percentage from the rate of return.
- A return of 5% taxed at 15% gives an after-tax return of 4.25%

$$0.05 \times 0.15 = 0.0075$$

$$0.05 - 0.0075 = 0.0425 = 4.25\%$$
- A return of 10% taxed at 25% gives an after-tax return of 7.5%

$$0.10 \times 0.25 = 0.025$$

$$0.10 - 0.025 = 0.075 = 7.5\%$$

Investors usually seek a higher rate of return on taxable investment returns than on non-taxable investment returns.

- A return may be adjusted for inflation to better indicate its true value in purchasing power. Any investment with a nominal rate of return less than the annual inflation rate represents a loss of value, even though the nominal rate of return might well be greater than 0%. When ROI is adjusted for inflation, the resulting return is considered an increase or decrease in purchasing power. If an ROI value is adjusted for inflation, it is stated explicitly, such as "The return, adjusted for inflation, was 2%."
- Many online poker tools include ROI in a player's tracked statistics, assisting users in evaluating an opponent's profitability.

Cash or potential cash returns

Time value of money

Investments generate cash flow to the investor to compensate the investor for the time value of money.

Except for rare periods of significant deflation where the opposite may be true, a dollar in cash is worth less today than it was yesterday, and worth more today than it will be worth tomorrow. The main factors that are used by investors to determine the rate of return at which they are willing to invest money include:

- estimates of future **inflation rates**
- estimates regarding the **risk of the investment** (e.g. how likely it is that investors will receive regular interest/dividend payments and the return of their full capital)
- whether or not the investors want the money available (“**liquid**”) for other uses.

The time value of money is reflected in the interest rates that banks offer for deposits, and also in the interest rates that banks charge for loans such as home mortgages. The “risk-free” rate is the rate on U.S. Treasury Bills, because this is the highest rate available without risking capital.

The rate of return which an investor expects from an investment is called the Discount Rate. Each investment has a different discount rate, based on the cash flow expected in future from the investment. The higher the risk, the higher the discount rate (rate of return) the investor will demand from the investment.

Compounding or reinvesting

Compound interest or other reinvestment of cash returns (such as interest and dividends) does not affect the discount rate of an investment, but it does affect the Annual Percentage Yield, because compounding/reinvestment increases the capital invested.

For example, if an investor put \$1,000 in a 1-year Certificate of Deposit (CD) that paid an annual interest rate of 4%, compounded quarterly, the CD would earn 1% interest per quarter on the account balance. The account balance includes interest previously credited to the account.

Compound Interest Example

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Capital at the beginning of the period	\$1,000	\$1,010	\$1,020.10	\$1,030.30
Dollar return for the period	\$10	\$10.10	\$10.20	\$10.30
Account Balance at end of the period	\$1,010.00	\$1,020.10	\$1,030.30	\$1,040.60
Quarterly ROI	1%	1%	1%	1%

The concept of 'income stream' may express this more clearly. At the beginning of the year, the investor took \$1,000 out of his pocket (or checking account) to invest in a CD at the bank. The money was still his, but it was no longer available for buying groceries. The investment provided a cash flow of \$10.00, \$10.10, \$10.20 and \$10.30. At the end of the year, the investor got \$1,040.60 back from the bank. \$1,000 was return of capital.

Once interest is earned by an investor it becomes capital. Compound interest involves reinvestment of capital; the interest earned during each quarter is reinvested. At the end of the first quarter the investor had capital of \$1,010.00, which then earned \$10.10 during the second quarter. The extra dime was interest on his additional \$10 investment. The Annual Percentage Yield or Future value for compound interest is higher than for simple interest because the interest is reinvested as capital and earns interest. The **yield** on the above investment was 4.06%.

Bank accounts offer contractually guaranteed returns, so investors cannot lose their capital. Investors/Depositors lend money to the bank, and the bank is obligated to give investors back their capital plus all earned interest. Because

investors are not risking losing their capital on a bad investment, they earn a quite low rate of return. But their capital steadily increases.

Returns when capital is at risk

Capital gains and losses

Many investments carry significant risk that the investor will lose some or all of the invested capital. For example, investments in company stock shares put capital at risk. The value of a stock share depends on what someone is willing to pay for it at a certain point in time. Unlike capital invested in a savings account, the capital value (price) of a stock share constantly changes. If the price is relatively stable, the stock is said to have “low volatility.” If the price often changes a great deal, the stock has “high volatility.” All stock shares have some volatility, and the change in price directly affects ROI for stock investments.

Stock returns are usually calculated for holding periods such as a month, a quarter or a year.

Reinvestment when capital is at risk: rate of return and yield

Example: Stock with low volatility and a regular quarterly dividend, reinvested

End of:	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Dividend	\$1	\$1.01	\$1.02	\$1.03
Stock Price	\$98	\$101	\$102	\$99
Shares Purchased	0.010204	0.01	0.01	0.010404
Total Shares Held	1.010204	1.020204	1.030204	1.040608
Investment Value	\$99	\$103.04	\$105.08	\$103.02
Quarterly ROI	-1%	4.08%	1.98%	-1.96%

Yield is the compound rate of return that includes the effect of reinvesting interest or dividends.

To the right is an example of a stock investment of **one share purchased at the beginning of the year for \$100**.

- The quarterly dividend is reinvested at the quarter-end stock price.
- The number of shares purchased each quarter = ($\$ \text{ Dividend} / \$ \text{ Stock Price}$).
- The final investment value of \$103.02 is a **3.02% Yield** on the initial investment of \$100. This is the compound yield, and this return can be considered to be the return on the investment of \$100.

To calculate the rate of return, the investor includes the reinvested dividends in the total investment. The investor received a total of \$4.06 in dividends over the year, all of which were reinvested, so the investment amount increased by \$4.06.

- Total Investment = Cost Basis = $\$100 + \$4.06 = \$104.06$.
- Capital gain/loss = $\$103.02 - \$104.06 = -\$1.04$ (a capital loss)
- $(\$4.06 \text{ dividends} - \$1.04 \text{ capital loss}) / \$104.06 \text{ total investment} = \mathbf{2.9\% \text{ ROI}}$

The disadvantage of this ROI calculation is that it does not take into account the fact that not all the money was invested during the entire year (the dividend reinvestments occurred throughout the year). The advantages are: (1) it uses the cost basis of the investment, (2) it clearly shows which gains are due to dividends and which gains/losses are due to capital gains/losses, and (3) the actual dollar return of \$3.02 is compared to the actual dollar investment of \$104.06.

For U.S. income tax purposes, if the shares were sold at the end of the year, dividends would be \$4.06, cost basis of the investment would be \$104.06, sale price would be \$103.02, and the capital loss would be \$1.04.

Since all returns were reinvested, the ROI might also be calculated as a **continuously compounded return** or **logarithmic return**. The effective continuously compounded rate of return is the natural log of the final investment value divided by the initial investment value:

- V_i is the initial investment (\$100)
- V_f is the final value (\$103.02)

$$\text{ROI}_{\text{Log}} = \ln \left(\frac{V_f}{V_i} \right) = \ln \left(\frac{103.02}{100} \right) = 2.98\%.$$

Mutual fund and investment company returns

Mutual funds, exchange-traded funds (ETFs), and other equitized investments (such as unit investment trusts or UITs, insurance separate accounts and related variable products such as variable universal life insurance policies and variable annuity contracts, and bank-sponsored commingled funds, collective benefit funds or common trust funds) are essentially portfolios of various investment securities such as stocks, bonds and money market instruments which are equitized by selling shares or units to investors. Investors and other parties are interested to know how the investment has performed over various periods of time.

Performance is usually quantified by a fund's total return. In the 1990s, many different fund companies were advertising various total returns—some cumulative, some averaged, some with or without deduction of sales loads or commissions, etc. To level the playing field and help investors compare performance returns of one fund to another, the U.S. Securities and Exchange Commission (SEC) began requiring funds to compute and report total returns based upon a standardized formula—so called "SEC Standardized total return" which is the average annual total return assuming reinvestment of dividends and distributions and deduction of sales loads or charges. Funds may compute and advertise returns on other bases (so-called "non-standardized" returns), so long as they also publish no less prominently the "standardized" return data.

Subsequent to this, apparently investors who'd sold their fund shares after a large increase in the share price in the late 1990s and early 2000s were ignorant of how significant the impact of income/capital gain taxes was on their fund "gross" returns. That is, they had little idea how significant the difference could be between "gross" returns (returns before federal taxes) and "net" returns (after-tax returns). In reaction to this apparent investor ignorance, and perhaps for other reasons, the SEC made further rule-making to require mutual funds to publish in their annual prospectus, among other things, total returns before and after the impact of U.S federal individual income taxes. And further, the after-tax returns would include 1) returns on a hypothetical taxable account after deducting taxes on dividends and capital gain distributions received during the illustrated periods and 2) the impacts of the items in #1) as well as assuming the entire investment shares were sold at the end of the period (realizing capital gain/loss on liquidation of the shares). These after-tax returns would apply of course only to taxable accounts and not to tax-deferred or retirement accounts such as IRAs.

Lastly, in more recent years, "personalized" investment returns have been demanded by investors. In other words, investors are saying more or less the fund returns may not be what their actual account returns are based upon the actual investment account transaction history. This is because investments may have been made on various dates and additional purchases and withdrawals may have occurred which vary in amount and date and thus are unique to the particular account. More and more fund and brokerage firms have begun providing personalized account returns on investor's account statements in response to this need.

With that out of the way, here's how basic earnings and gains/losses work on a mutual fund. The fund records income for dividends and interest earned which typically increases the value of the mutual fund shares, while expenses set aside have an offsetting impact to share value. When the fund's investments increase in market value, so too does the value of the fund shares (or units) owned by the investors. When investments increase (decrease) in market value, so too the fund shares value increases (or decreases). When the fund sells investments at a profit, it turns or reclassifies that paper profit or unrealized gain into an actual or realized gain. The sale has no effect on the

value of fund shares but it has reclassified a component of its value from one bucket to another on the fund books—which will have future impact to investors. At least annually, a fund usually pays dividends from its net income (income less expenses) and net capital gains realized out to shareholders as an IRS requirement. This way, the fund pays no taxes but rather all the investors in taxable accounts do. Mutual fund share prices are typically valued each day the stock or bond markets are open and typically the value of a share is the net asset value of the fund shares investors own.

Total returns

This section addresses only total returns without the impact of U.S. federal individual income and capital gains taxes. Mutual funds report **total returns** assuming reinvestment of dividend and capital gain distributions. That is, the dollar amounts distributed are used to purchase additional shares of the funds as of the reinvestment/ex-dividend date. Reinvestment rates or factors are based on total distributions (dividends plus capital gains) during each period.

- Year 1 Reinvestment Factor = $\frac{\text{Year 1 Total Distribution}}{\text{Year 1 Share Price}} + 1$
- Year 2 Reinvestment Factor = $\frac{\text{Year 2 Total Distribution} \times \text{Year 1 Reinvestment Factor}}{\text{Year 2 Share Price}} + 1$
- Year 3 Reinvestment Factor = $\frac{\text{Year 3 Total Distribution} \times \text{Year 2 Reinvestment Factor}}{\text{Year 3 Share Price}} + 1$
- Year 4 Reinvestment Factor = $\frac{\text{Year 4 Total Distribution} \times \text{Year 3 Reinvestment Factor}}{\text{Year 4 Share Price}} + 1$
- Year 5 Reinvestment Factor = $\frac{\text{Year 5 Total Distribution} \times \text{Year 4 Reinvestment Factor}}{\text{Year 5 Share Price}} + 1$
- Total Return = $\frac{\text{Final Price} \times \text{Last Reinvestment Factor}}{\text{Beginning Price}} - 1$

Average annual total return (geometric)

US mutual funds are to compute average annual total return as prescribed by the U.S. Securities and Exchange Commission (SEC) in instructions to form N-1A (the fund prospectus) as the average annual compounded rates of return for 1-year, 5-year and 10-year periods (or inception of the fund if shorter) as the "average annual total return" for each fund. The following formula is used:^[6]

$$P(1 + T)^n = \text{ERV}$$

Where:

P = a hypothetical initial payment of \$1,000.

T = average annual total return.

n = number of years.

ERV = ending redeemable value of a hypothetical \$1,000 payment made at the beginning of the 1-, 5-, or 10-year periods at the end of the 1-, 5-, or 10-year periods (or fractional portion).

Solving for T gives

$$T = \left(\frac{\text{ERV}}{P} \right)^{1/n} - 1$$

Example

Example: Balanced mutual fund during boom times with regular annual dividends, reinvested at time of distribution, initial investment \$1,000 at end of year 0, share price \$14.21

	Year 1	Year 2	Year 3	Year 4	Year 5
Dividend per share	\$0.26	\$0.29	\$0.30	\$0.50	\$0.53
Capital gain distribution per share	\$0.06	\$0.39	\$0.47	\$1.86	\$1.12
Total Distribution Per Share	\$0.32	\$0.68	\$0.77	\$2.36	\$1.65
Share Price At End Of Year	\$17.50	\$19.49	\$20.06	\$20.62	\$19.90
Reinvestment factor	1.01829	1.03553	1.03975	1.11900	1.09278
Shares owned before distribution	70.373	71.676	74.125	76.859	84.752
Total distribution	\$22.52	\$48.73	\$57.10	\$181.73	\$141.60
Share price at distribution	\$17.28	\$19.90	\$20.88	\$22.98	\$21.31
Shares purchased	1.303	2.449	2.734	7.893	6.562
Shares owned after distribution	71.676	74.125	76.859	84.752	91.314

- Total return = $((\$19.90 \times 1.09278) / \$14.21) - 1 = 53.04\%$
- Average annual total return (geometric) = $((\$19.90 \times 91.314) / \$1,000)^{(1/5)} - 1 = 12.69\%$

Using a Holding Period Return calculation, after five years, an investor who reinvested owned 91.314 shares valued at \$19.90 per share. $((\$19.90 \times 91.314) / \$1,000) - 1 / 5 = 16.34\%$ return. An investor who did not reinvest received total cash payments of \$5.78 per share. $((\$19.90 + \$5.78) / \$14.21) - 1 / 5 = 16.14\%$ return.

Mutual funds include capital gains as well as dividends in their return calculations. Since the market price of a mutual fund share is based on net asset value, a capital gain distribution is offset by an equal decrease in mutual fund share value/price. From the shareholder's perspective, a capital gain distribution is not a net gain in assets, but it is a realized capital gain.

Summary: overall rate of return

Rate of Return and **Return on Investment** indicate cash flow from an investment to the investor over a specified period of time, usually a year.

ROI is a measure of investment profitability, not a measure of investment size. While compound interest and dividend reinvestment can increase the size of the investment (thus potentially yielding a higher dollar return to the investor), **Return on Investment** is a percentage return based on capital invested.

In general, the higher the investment risk, the greater the potential investment return, and the greater the potential investment loss.

Notes

- [1] This statement and the example calculations all follow from the difference of squares formula, $(x + y)(x - y) = x^2 - y^2$. For $x = 100\%$ the terms have average 100% but product less than 100%.
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Initial public offering

An **initial public offering (IPO)** or **stock market launch** is a type of public offering where shares of stock in a company are sold to the general public, on a securities exchange, for the first time. Through this process, a private company transforms into a public company. Initial public offerings are used by companies to raise expansion capital, to possibly monetize the investments of early private investors, and to become publicly traded enterprises. A company selling shares is never required to repay the capital to its public investors. After the IPO, when shares trade freely in the open market, money passes between public investors. Although an IPO offers many advantages, there are also significant disadvantages. Chief among these are the costs associated with the process, and the requirement to disclose certain information that could prove helpful to competitors, or create difficulties with vendors. Details of the proposed offering are disclosed to potential purchasers in the form of a lengthy document known as a prospectus. Most companies undertaking an IPO do so with the assistance of an investment banking firm acting in the capacity of an underwriter. Underwriters provide a valuable service, which includes help with correctly assessing the value of shares (share price), and establishing a public market for shares (initial sale). Alternative methods such as the dutch auction have also been explored. In terms of size and public participation, the most notable example of this method is the Google IPO.^[1] China has recently emerged as a major IPO market, with several of the largest IPOs taking place in that country.

History

The earliest form of a company which issued **public shares** was the *publicani* during the Roman Republic. Like modern joint-stock companies, the *publicani* were legal bodies independent of their members whose ownership was divided into shares, or *partes*. There is evidence that these shares were sold to public investors and traded in a type of over-the-counter market in the Forum, near the Temple of Castor and Pollux. The shares fluctuated in value, encouraging the activity of speculators, or *quaestors*. Mere evidence remains of the prices for which *partes* were sold, the nature of initial public offerings, or a description of stock market behavior. *Publicanis* lost favor with the fall of the Republic and the rise of the Empire.^[2]

In March 1602 the “Vereenigde Oost-Indische Compagnie (VOC), or Dutch East India Company was formed. The VOC was the first modern company to issue public shares, and it is this issuance, at the beginning of the 17th century, that is considered the first modern IPO. The company had an original paid-up share capital of 6,424,588 guilders. The ability to raise this large sum is attributable to the decision taken by the owners to open up access to share ownership to a wide public. Everyone living in the United Provinces had an opportunity to participate in the Company. Each share was worth 3000 guilders (roughly equivalent to US\$1,500).^[3] All the shares were tradable, and the shareholders received receipts for the purchase. A share certificate documenting payment and ownership such as we know today was not issued but ownership was instead entered in the company’s share register.^[4]

In the United States, the first IPO was the public offering of Bank of North America.^[5]

Reasons for listing

When a company lists its securities on a public exchange, the money paid by the investing public for the newly issued shares goes directly to the company (primary offering) as well as to any early private investors who opt to sell all or a portion of their holdings (secondary offering) as part of the larger IPO. An IPO, therefore, allows a company to tap into a wide pool of potential investors to provide itself with capital for future growth, repayment of debt, or working capital. A company selling common shares is never required to repay the capital to its public investors. Those investors must endure the unpredictable nature of the open market to price and trade their shares. After the IPO, when shares trade freely in the open market, money passes between public investors. For early private investors who choose to sell shares as part of the IPO process, the IPO represents an opportunity to monetize their investment. After the IPO, once shares trade in the open market, investors holding large blocks of shares can either sell those shares piecemeal in the open market, or sell a large block of shares directly to the public, at a fixed price, through a secondary market offering. This type of offering is not dilutive, since no new shares are being created.

Once a company is listed, it is able to issue additional common shares in a number of different ways, one of which is the follow-on offering. This method provides capital for various corporate purposes through the issuance of equity (see stock dilution) without incurring any debt. This ability to quickly raise potentially large amounts of capital from the marketplace is a key reason many companies seek to go public.

An IPO accords several benefits to the previously private company:

- Enlarging and diversifying equity base
- Enabling cheaper access to capital
- Increasing exposure, prestige, and public image
- Attracting and retaining better management and employees through liquid equity participation
- Facilitating acquisitions (potentially in return for shares of stock)
- Creating multiple financing opportunities: equity, convertible debt, cheaper bank loans, etc.

Advance Planning

Careful advance planning is crucial to a successful IPO. One book^[6] suggests the following 7 advance planning steps: (1) develop an impressive management and professional team; (2) grow the company's business with an eye to the public marketplace; (3) obtain audited or auditable financial statements using IPO-accepted accounting principles; (4) clean up the company's act; (5) establish antitakeover defenses; (6) develop good corporate governance; (7) create insider bail-out opportunities and take advantage of IPO windows.

Disadvantages of an IPO

There are several disadvantages to completing an initial public offering:

- Significant legal, accounting and marketing costs, many of which are ongoing
- Requirement to disclose financial and business information
- Meaningful time, effort and attention required of senior management
- Risk that required funding will not be raised
- Public dissemination of information which may be useful to competitors, suppliers and customers.

Procedure

IPOs generally involve one or more investment banks known as "underwriters". The company offering its shares, called the "issuer", enters into a contract with a lead underwriter to sell its shares to the public. The underwriter then approaches investors with offers to sell those shares.

The sale (allocation and pricing) of shares in an IPO may take several forms. Common methods include:

- Best efforts contract
- Firm commitment contract
- All-or-none contract
- Bought deal

A large IPO is usually underwritten by a "syndicate" of investment banks, the largest of which take the position of "lead underwriter". Upon selling the shares, the underwriters retain a portion of the proceeds as their fee. This fee is called an underwriting spread. The spread is calculated as a discount from the price of the shares sold (called the gross spread). Components of an underwriting spread in an initial public offering (IPO) typically include the following (on a per share basis): Manager's fee, Underwriting fee—earned by members of the syndicate, and the Concession—earned by the broker-dealer selling the shares. The Manager would be entitled to the entire underwriting spread. A member of the syndicate is entitled to the underwriting fee and the concession. A broker dealer who is not a member of the syndicate but sells shares would receive only the concession, while the member of the syndicate who provided the shares to that broker dealer would retain the underwriting fee.^[7] Usually, the managing/lead underwriter, also known as the bookrunner, typically the underwriter selling the largest proportions of the IPO, takes the highest portion of the gross spread, up to 8% in some cases.

Multinational IPOs may have many syndicates to deal with differing legal requirements in both the issuer's domestic market and other regions. For example, an issuer based in the E.U. may be represented by the main selling syndicate in its domestic market, Europe, in addition to separate syndicates or selling groups for US/Canada and for Asia. Usually, the lead underwriter in the main selling group is also the lead bank in the other selling groups.

Because of the wide array of legal requirements and because it is an expensive process, IPOs typically involve one or more law firms with major practices in securities law, such as the Magic Circle firms of London and the white shoe firms of New York City.

Public offerings are sold to both institutional investors and retail clients of the underwriters. A licensed securities salesperson (Registered Representative in the USA and Canada) selling shares of a public offering to his clients is

paid a portion of the selling concession (the fee paid by the issuer to the underwriter) rather than by his client. In some situations, when the IPO is not a "hot" issue (undersubscribed), and where the salesperson is the client's advisor, it is possible that the financial incentives of the advisor and client may not be aligned.

The issuer usually allows the underwriters an option to increase the size of the offering by up to 15% under certain circumstance known as the greenshoe or overallotment option. This option is always exercised when the offering is considered a "hot" issue, by virtue of being oversubscribed.

In the USA, clients are given a preliminary prospectus, known as a red herring prospectus, during the initial quiet period. The red herring prospectus is so named because of a bold red warning statement printed on its front cover. The warning states that the offering information is incomplete, and may be changed. The actual wording can vary, although most roughly follow the format exhibited on the Facebook IPO red herring.^[8] During the quiet period, the shares cannot be offered for sale. Brokers can, however, take indications of interest from their clients. At the time of the stock launch, after the Registration Statement has become effective, indications of interest can be converted to buy orders, at the discretion of the buyer. Sales can only be made through a final prospectus cleared by the Securities and Exchange Commission.

Before legal actions initiated by New York Attorney General Eliot Spitzer, which later became known as the Global Settlement enforcement agreement, some large investment firms had initiated favorable research coverage of companies in an effort to aid Corporate Finance departments and retail divisions engaged in the marketing of new issues. The central issue in that enforcement agreement had been judged in court previously. It involved the conflict of interest between the investment banking and analysis departments of ten of the largest investment firms in the United States. The investment firms involved in the settlement had all engaged in actions and practices that had allowed the inappropriate influence of their research analysts by their investment bankers seeking lucrative fees.^[9] A typical violation addressed by the settlement was the case of CSFB and Salomon Smith Barney, which were alleged to have engaged in inappropriate spinning of "hot" IPOs and issued fraudulent research reports in violation of various sections within the Securities Exchange Act of 1934.

Dutch Auction

A Dutch Auction allows shares of an initial public offering to be allocated based only on price aggressiveness, with all successful bidders paying the same price per share.^{[10][11]} One version of the Dutch auction is OpenIPO, which is based on an auction system designed by Nobel Prize-winning economist William Vickrey. This auction method ranks bids from highest to lowest, then accepts the highest bids that allow all shares to be sold, with all winning bidders paying the same price. It is similar to the model used to auction Treasury bills, notes, and bonds since the 1990s. Before this, Treasury bills were auctioned through a discriminatory or pay-what-you-bid auction, in which the various winning bidders each paid the price (or yield) they bid, and thus the various winning bidders did not all pay the same price. Both discriminatory and uniform price or "Dutch" auctions have been used for IPOs in many countries, although only uniform price auctions have been used so far in the US.

A variation of the Dutch Auction has been used to take a number of companies public including Morningstar, Interactive Brokers Group, Overstock.com, Ravenswood Winery, Clean Energy Fuels, and Boston Beer Company.^[12] In 2004, Google used the Dutch Auction system for its Initial Public Offering.^[13] Traditional investment banks have shown resistance to the idea of using an auction process to engage in public securities offerings. The auction method allows for equal access to the allocation of shares and eliminates the favorable treatment accorded important clients by the underwriters in conventional IPOs. In the face of this resistance, the Dutch Auction is still a little used method in public offerings.

In determining the success or failure of a Dutch Auction, one must consider competing objectives.^{[14][15]} If the objective is to reduce risk, a traditional IPO may be more effective because the underwriter manages the process, rather than leaving the outcome in part to random chance in terms of who chooses to bid or what strategy each bidder chooses to follow. From the viewpoint of the investor, the Dutch Auction allows everyone equal access. Moreover,

some forms of the Dutch Auction allow the underwriter to be more active in coordinating bids and even communicating general auction trends to some bidders during the bidding period. From the viewpoint of the investor, the Dutch Auction would be more effective at price discovery, and potentially result in a lower offering price.

There is no evidence to indicate that the Dutch Auction fares any better than the traditional IPO in an unwelcoming market environment. A Dutch Auction IPO by WhiteGlove Health, Inc., announced in May of 2011 was postponed in September of that year, after several failed attempts to price. An article in the *Wall Street Journal* cited the reasons as "Broader stock-market volatility and uncertainty about the global economy have made investors wary of investing in new stocks."^{[16][17]}

Direct Public Offering

Financial historians Richard Sylla and Robert E. Wright have shown that before 1860 most early U.S. corporations sold shares in themselves directly to the public without the aid of intermediaries like investment banks.^[18] The direct public offering or DPO, as they term it,^[19] was not done by auction but rather at a share price set by the issuing corporation. In this sense, it is the same as the fixed price public offers that were the traditional IPO method in most non-US countries in the early 1990s. The DPO eliminated the agency problem associated with offerings intermediated by investment banks. There has recently been a movement based on crowdfunding to revive the popularity of Direct Public Offerings.^[20]

Pricing of IPO

A company planning an IPO typically appoints a lead manager, known as a bookrunner, to help it arrive at an appropriate price at which the shares should be issued. There are two primary ways in which the price of an IPO can be determined. Either the company, with the help of its lead managers, fixes a price (fixed price method) or the price can be determined through analysis of confidential investor demand data, compiled by the bookrunner. That process is known as book building.

Historically, some IPOs both globally and in the United States have been underpriced. The effect of "initial underpricing" an IPO is to generate additional interest in the stock when it first becomes publicly traded. Flipping, or quickly selling shares for a profit, can lead to significant gains for investors who have been allocated shares of the IPO at the offering price. However, underpricing an IPO results in lost potential capital for the issuer. One extreme example is theglobe.com IPO which helped fuel the IPO "mania" of the late 90's internet era. Underwritten by Bear Stearns on November 13, 1998, the IPO was priced at \$9 per share. The share price quickly increased 1000% after the opening of trading, to a high of \$97. Selling pressure from institutional flipping eventually drove the stock back down, and it closed the day at \$63. Although the company did raise about \$30 million from the offering it is estimated that with the level of demand for the offering and the volume of trading that took place the company might have left upwards of \$200 million on the table.

The danger of overpricing is also an important consideration. If a stock is offered to the public at a higher price than the market will pay, the underwriters may have trouble meeting their commitments to sell shares. Even if they sell all of the issued shares, the stock may fall in value on the first day of trading. If so, the stock may lose its marketability and hence even more of its value. This could result in losses for investors, many of whom being the most favored clients of the underwriters.

Underwriters, therefore, take many factors into consideration when pricing an IPO, and attempt to reach an offering price that is low enough to stimulate interest in the stock, but high enough to raise an adequate amount of capital for the company. The process of determining an optimal price usually involves the underwriters ("syndicate") arranging share purchase commitments from leading institutional investors.

Some researchers (e.g. Geoffrey C., and C. Swift, 2009) believe that the underpricing of IPOs is less a deliberate act on the part of issuers and/or underwriters, than the result of an over-reaction on the part of investors (Friesen & Swift, 2009). One potential method for determining underpricing is through the use of IPO Underpricing Algorithms.

Quiet period

There are two time windows commonly referred to as "quiet periods" during an IPO's history. The first and the one linked above is the period of time following the filing of the company's S-1 but before SEC staff declare the registration statement effective. During this time, issuers, company insiders, analysts, and other parties are legally restricted in their ability to discuss or promote the upcoming IPO (U.S. Securities and Exchange Commission, 2005).

The other "quiet period" refers to a period of 40 calendar days following an IPO's first day of public trading. During this time, insiders and any underwriters involved in the IPO are restricted from issuing any earnings forecasts or research reports for the company. Regulatory changes enacted by the SEC as part of the Global Settlement enlarged the "quiet period" from 25 days to 40 days on July 9, 2002. When the quiet period is over, generally the underwriters will initiate research coverage on the firm. Additionally, the NASDAQ and NYSE have approved a rule mandating a 10-day quiet period after a Secondary Offering and a 15-day quiet period both before and after expiration of a "lock-up agreement" for a securities offering.

Stag profit

Stag profit is a situation in the stock market before and immediately after a company's Initial public offering (or any new issue of shares). A **stag** is a party or individual who subscribes to the new issue expecting the price of the stock to rise immediately upon the start of trading. Thus, stag profit is the financial gain accumulated by the party or individual resulting from the value of the shares rising. This term is more popular in the United Kingdom than in the United States. In the US, such investors are usually called flippers, because they get shares in the offering and then immediately turn around and 'flip' or sell them on the first day of trading.

Share Delivery

Not all IPOs are eligible for delivery settlement through the DTC system, which would then either require the physical delivery of the stock certificates to the clearing agent bank's custodian, or a delivery versus payment (DVP) arrangement with the selling group brokerage firm.

Largest IPOs

1. Agricultural Bank of China US\$22.1 billion (2010)^[21]
2. Industrial and Commercial Bank of China US\$21.9 billion (2006)^[22]
3. American International Assurance US\$20.5 billion (2010)^[23]
4. Visa Inc. US\$19.7 billion (2008)^[24]
5. General Motors US\$18.15 billion (2010)^[25]
6. Facebook, Inc. US\$16 billion (2012)^[26]

Value of IPOs

Prior to 2009, the United States was the leading issuer of IPOs in terms of total value. Since that time, however, China (Shanghai, Shenzhen and Hong Kong) has been the leading issuer, raising \$73 billion (almost double the amount of money raised on the New York Stock Exchange and NASDAQ combined) up to the end of November 2011. The Hong Kong Stock Exchange raised 30.9 billion in 2011 as the top course for the third year in a row, while New York raised 30.7 billion.^[27]

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External links

- Initial Public Offering (IPO) Definition and Calendar, Wikinvest
- IPO Guide (<http://www.wsgr.com/publications/PDFSearch/ipoguide2010.pdf>) from Wilson Sonsini Goodrich & Rosati
- How IPO works – HowStuff Works (<http://www.howstuffworks.com/ipo1.htm>.)

Exit strategy

An **exit strategy** is a means of leaving one's current situation, either after a predetermined objective has been achieved, or as a strategy to mitigate failure.^{[1][2][3]} An organisation or individual without an exit strategy may be in a quagmire. At worst, an exit strategy will save face; at best, an exit strategy will peg a withdrawal to the achievement of an objective worth more than the cost of continued involvement.

In warfare

In military strategy an exit strategy is understood to minimise losses of what military jargon called blood and treasure (lives and material).

The term was used technically in internal Pentagon critiques of the Vietnam War (cf. President Richard Nixon's promise of Peace With Honor), but remained obscure to the general public until the Battle of Mogadishu, Somalia when the U.S. military involvement in that U.N. peacekeeping operation cost the lives of U.S. troops without a clear objective. Republican critics of President Bill Clinton derided him for having no *exit strategy*, although he had inherited an active military operation from his predecessor, President George H. W. Bush. The criticism was revived later against the U.S. involvement in the Yugoslav wars, including peacekeeping operations in Bosnia and Kosovo and the Kosovo war against Serbia.

The term has been adopted by critics of U.S. involvement in Afghanistan and especially Iraq. President George W. Bush was said to have no exit strategy to remove troops from Iraq, and critics worried about the number of Coalition soldiers and Iraqi civilians who would suffer injury or death as a result. President Barack Obama also has not yet publicly announced an exit strategy for the troops in Afghanistan.

In business

In entrepreneurship and strategic management an exit strategy, exit plan, or strategic withdrawal, is a way to transition one's ownership of a company or the operation of some part of the company. Entrepreneurs and investors devise ways of recouping the capital they have invested in a company. The most common strategy is the sale of equity to someone else through a trade sale.

Transition companies are professional mergers and acquisitions companies that assist Middle Market business owners with their exit strategy. Services offered are often referred to as Transition Management services.

From time to time, management may decide it is necessary to downsize its operations. This typically involves discontinuing less profitable brands, products, product lines, or operating divisions.

Other types of exit strategy are:

Management buyout or employee buyout (common in the manufacturing industry)

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External links

- 1993 White House press briefing (<http://www.clintonfoundation.org/legacy/092893-press-briefing-by-dee-dee-myers.htm>) - quoting Brent Scowcroft on exit strategy

More entrepreneurish stuff

Business incubator

Business incubators are programs designed to support the successful development of entrepreneurial companies through an array of business support resources and services, developed and orchestrated by incubator management and offered both in the incubator and through its network of contacts. Incubators vary in the way they deliver their services, in their organizational structure, and in the types of clients they serve. Successful completion of a business incubation program increases the likelihood that a startup company will stay in business for the long term: older studies found 87% of incubator graduates stayed in business,^[1] in contrast to 44% of all firms.^[2]

Incubators differ from research and technology parks in their dedication to startup and early-stage companies. Research and technology parks, on the other hand, tend to be large-scale projects that house everything from corporate, government or university labs to very small companies. Most research and technology parks do not offer business assistance services, which are the hallmark of a business incubation program. However, many research and technology parks house incubation programs.

Incubators also differ from the U.S. Small Business Administration's Small Business Development Centers (and similar business support programs) in that they serve only selected clients. SBDCs are required by law to offer general business assistance to any company that contacts them for help. In addition, SBDCs work with any small business at any stage of development, not only startup companies. Many business incubation programs partner with their local SBDC to create a "one-stop shop" for entrepreneurial support.

In 2005 alone, North American incubation programs assisted more than 27,000 companies that provided employment for more than 100,000 workers and generated annual revenues of \$17 billion.^[3]

The incubation process

Most common incubator services:^[4]

- Help with business basics
 - Networking activities
 - Marketing assistance
 - High-speed Internet access
 - Help with accounting/financial management
 - Access to bank loans, loan funds and guarantee programs
 - Help with presentation skills
 - Links to higher education resources
 - Links to strategic partners
 - Access to angel investors or venture capital
 - Comprehensive business training programs
 - Advisory boards and mentors
 - Management team identification
 - Help with business etiquette
 - Technology commercialization assistance
 - Help with regulatory compliance
 - Intellectual property management
-

Unlike many business assistance programs, business incubators do not serve any and all companies. Entrepreneurs who wish to enter a business incubation program must apply for admission. Acceptance criteria vary from program to program, but in general only those with feasible business ideas and a workable business plan are admitted. It is this factor that makes it difficult to compare the success rates of incubated companies against general business survival statistics.^[5]

Although most incubators offer their clients office space and shared administrative services, the heart of a true business incubation program is the services it provides to startup companies.

More than half of incubation programs surveyed by the National Business Incubation Association ^[6] in 2006 reported that they also served affiliate or virtual clients.^[7] These companies do not reside in the incubator facility. Affiliate clients may be home-based businesses or early-stage companies that have their own premises but can benefit from incubator services. Virtual clients may be too remote from an incubation facility to participate on site, and so receive counseling and other assistance electronically.

The amount of time a company spends in an incubation program can vary widely depending on a number of factors, including the type of business and the entrepreneur's level of business expertise. Life science and other firms with long research and development cycles require more time in an incubation program than manufacturing or service companies that can immediately produce and bring a product or service to market. On average, incubator clients spend 33 months in a program.^[7] Many incubation programs set graduation requirements by development benchmarks, such as company revenues or staffing levels, rather than time in the program.

Incubator types, goals, and sponsors

Industry sectors intentionally supported by incubation programs ^[7]
Technology
Computer software
Services/professional
Manufacturing
Internet
Biosciences/life sciences
Electronics/microelectronics
Telecommunications
Computer hardware
Medical devices
Creative industries
eBusiness and eCommerce
Wireless technology
Healthcare technology
Advanced materials
Defense/homeland security
Energy
Environment/clean technologies
Media
Nanotechnology

Construction
Arts
Aerospace
Kitchen/food
Retail
Fashion
Wood/forestry
Tourism

More than half of all business incubation programs are "mixed-use" projects; that is, they work with clients from a variety of industries. Technology incubators account for 39% of incubation programs.^[7]

Business incubation has been identified as a means of meeting a variety of economic and socioeconomic policy needs, which may include

- Creating jobs and wealth
- Fostering a community's entrepreneurial climate
- Technology commercialization
- Diversifying local economies
- Building or accelerating growth of local industry clusters
- Business creation and retention
- Encouraging women or minority entrepreneurship
- Identifying potential spin-in or spin-out business opportunities
- Community revitalization^[8]

About one-third of business incubation programs are sponsored by economic development organizations. Government entities (such as cities or counties) account for 21% of program sponsors. Another 20% are sponsored by academic institutions, including two- and four-year colleges, universities, and technical colleges.^[7]

In many countries, incubation programs are funded by regional or national governments as part of an overall economic development strategy. In the United States, however, most incubation programs are independent, community-based and resourced projects. The U.S. Economic Development Administration is a frequent source of funds for developing incubation programs, but once a program is open and operational it typically receives no federal funding; few states offer centralized incubator funding. Rents and/or client fees account for 59% of incubator revenues, followed by service contracts or grants (18%) and cash operating subsidies (15%).^[7]

As part of a major effort to address the ongoing economic crisis of the US, legislation was introduced to "reconstitute Project Socrates". The updated version of Socrates supports incubators by enabling users with technology-based facts about the marketplace, competitor maneuvers, potential partners, and technology paths to achieve competitive advantage. Michael Sekora, the original creator and director of Socrates says that a key purpose of Socrates is to assist government economic planners in addressing the economic and socioeconomic issues (see above) with unprecedented speed, efficiency and agility.^[9]

Many for-profit or "private" incubation programs were launched in the late 1990s by investors and other for-profit seeking to hatch businesses quickly and bring in big payoffs. At the time, NBIA estimated that nearly 30% of all incubation programs were for-profit ventures. In the wake of the dot-com bust, however, many of those programs closed. In NBIA's 2002 State of the Business Incubation survey, only 16% of responding incubators were for-profit programs. By the 2006 SOI, just 6% of respondents were for-profit.^[7]

Although some incubation programs (regardless of nonprofit or for-profit status) take equity in client companies, most do not. Only 25% of incubation programs report that they take equity in some or all of their clients.^[7]

History

The formal concept of business incubation began in the USA in 1959 when Joseph Mancuso opened the Batavia Industrial Center in a Batavia, New York, warehouse.^[10] Incubation expanded in the U.S. in the 1980s and spread to the UK and Europe through various related forms (e.g. innovation centres, pépinières d'entreprises, technopoles/science parks).

The U.S.-based National Business Incubation Association estimates that there are about 7,000 incubators worldwide. As of October 2006, there were more than 1,400 incubators in North America, up from only 12 in 1980. Her Majesty's Treasury identified around 25 incubation environments in the UK in 1997; by 2005, UKBI identified around 270 incubation environments across the country. A study funded by the European Commission in 2002 identified around 900 incubation environments in Western Europe.^[11]

Incubation activity has not been limited to developed countries; incubation environments are now being implemented in developing countries and raising interest for financial support from organisations such as UNIDO and the World Bank.

On November 3, 2010, New York City broke ground on its sixth business incubator and the first in the Bronx called the Sunshine Bronx Business Incubator^[12] which is a joint venture between the New York City Economic Development Corporation and Sunshine Suites.

Incubators are going through a renaissance as of 2011. New experiments like Virtual Business Incubators are bringing the resources of entrepreneurship hubs like Silicon Valley to remote locations all over the world.

Incubator networks

For many years now, incubators aggregated themselves into networks. These network are used to share good practises and can spread new methodologies. Europe has the well established European Business Centre (EBN) association that federate more than 250 eBICs all over the Europe. EBN is animate its network for 25 years now. France has its national network of technopoles, pre-incubators, and eBICs: RETIS-INNOVATION. This network mutualize resources to internationalize startups. Spain has a national network too: ANCES that regroup more than 30 eBICs.

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External links

- Business incubator (http://www.dmoz.org/Business/Small_Business/Start_Up/Incubators/) at the Open Directory Project
- Forbes ranking of incubators (<http://www.forbes.com/sites/tomiogeron/2012/04/30/top-tech-incubators-as-ranked-by-forbes-y-combinator-tops-with-7-billion-in-value/>)
- European Business & Innovation Center Network (<http://www.ebn.eu/>)

Virtual business incubator

Business incubators began in the 1950s and really took off in the late 1990s as support for startup companies who need advice and venture capital to get their ideas off the ground. As the dot-com bubble burst, many high-tech business incubators did so too. Now the model of a business incubator is changing. Several of the incubator companies who survived the dot-com bubble switched to a **virtual** model.^[1]

The old incubator model required a startup venture to set up shop at the incubator's site. The virtual model, on the other hand, allows a company to garner the advice of an incubator without actually being located at the incubator site. This new model suits those entrepreneurs who need the advice an incubator offers but still want to maintain their own offices, warehouses, etc.

Several state and local governments in the United States are working with or creating their own virtual business incubators to attract new business.

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-

Strategic planning

Strategic planning is an organization's process of defining its strategy, or direction, and making decisions on allocating its resources to pursue this strategy. In order to determine the direction of the organization, it is necessary to understand its current position and the possible avenues through which it can pursue a particular course of action. Generally, strategic planning deals with at least one of three key questions:^[1]

1. "What do we do?"
2. "For whom do we do it?"
3. "How do we excel?"

In many organizations, this is viewed as a process for determining where an organization is going over the next year or—more typically—3 to 5 years (long term), although some extend their vision to 20 years.

Key components

The key components of 'strategic planning' include an understanding of the firm's vision, mission, values and strategies. (Often a "Vision Statement" and a "Mission Statement" may encapsulate the vision and mission).

- **Vision:** outlines what the organization wants to be, or how it wants the world in which it operates to be (an "idealised" view of the world). It is a long-term view and concentrates on the future. It can be emotive and is a source of inspiration.

For example, a charity working with the poor might have a vision statement which reads "A World without Poverty."

- **Mission:** Defines the fundamental purpose of an organization or an enterprise, succinctly describing why it exists and what it does to achieve its vision. For example, the charity above might have a mission statement as "providing jobs for the homeless and unemployed".
- **Values:** Beliefs that are shared among the stakeholders of an organization. Values drive an organization's culture and priorities and provide a framework in which decisions are made. For example, "Knowledge and skills are the keys to success" or "give a man bread and feed him for a day, but teach him to farm and feed him for life". These example maxims may set the priorities of self-sufficiency over shelter.
- **Strategy:** Strategy, narrowly defined, means "the art of the general". - a combination of the ends (goals) for which the firm is striving and the means (policies) by which it is seeking to get there. A strategy is sometimes called a roadmap - which is the path chosen to plow towards the end vision. The most important part of implementing the strategy is ensuring the company is going in the right direction which is towards the end vision.

Organizations sometimes summarize goals and objectives into a **mission statement** and/or a **vision statement**. Others begin with a vision and mission and use them to formulate goals and objectives.

Many people mistake the vision statement for the mission statement, and sometimes one is simply used as a longer term version of the other. However they are distinct; with the vision being a descriptive picture of a desired future state; and the mission being a statement of a rationale, applicable now as well as in the future. The mission is therefore the means of successfully achieving the vision. This may be in the business world or the military.



Video explaining the strategic plan of the Wikimedia Foundation

For an organisation's vision and mission to be effective, they must become assimilated into the organization's culture. They should also be assessed internally and externally. The internal assessment should focus on how members inside the organization interpret their mission statement. The external assessment — which includes all of the businesses stakeholders — is valuable since it offers a different perspective. These discrepancies between these two assessments can provide insight into their effectiveness.

A vision statement is a declaration of where you are headed—your future state - to formulate a picture of what your organization's future makeup will be, and where the organization is headed.

Strategic planning process

There are many approaches to strategic planning but typically one of the following approaches is used:

Situation-Target-Proposal

- **Situation** - evaluate the current situation and how it came about.
- **Target** - define goals and/or objectives (sometimes called ideal state)
- **Path / Proposal** - map a possible route to the goals/objectives

Draw-See-Think-Plan

- **Draw** - what is the ideal image or the desired end state?
- **See** - what is today's situation? What is the gap from ideal and why?
- **Think** - what specific actions must be taken to close the gap between today's situation and the ideal state?
- **Plan** - what resources are required to execute the activities?

Tools and approaches

Among the most useful tools for strategic planning is SWOT analysis (Strengths, Weaknesses, Opportunities, and Threats). The main objective of this tool is to analyze internal strategic factors, strengths and weaknesses attributed to the organization, and external factors beyond control of the organization such as opportunities and threats.

Other tools include:

- Balanced Scorecards, which creates a systematic framework for strategic planning;
- Scenario planning, which was originally used in the military and recently used by large corporations to analyze future scenarios.
- PEST analysis (**P**olitical, **E**conomic, **S**ocial, and **T**echnological)
- STEER analysis (**S**ocio-cultural, **T**echnological, **E**conomic, **E**cological, and **R**egulatory factors)
- EPISTEL (**E**nvironment, **P**olitical, **I**nformatic, **S**ocial, **T**echnological, **E**conomic and **L**egal).
- ATM Approach (**A**ntecedent Conditions, **T**arget Strategies, **M**easure Progress and Impact).^[2] Once an understanding of the desired endstate is defined, the ATM approach uses Root Cause Analysis (RCA) to understand the threats, barriers, and challenges to achieving the endstate. Not all antecedent conditions identified through RCA are within the direct and immediate control of the organization to change. Therefore, a review of organizational resources, both human and financial, are used to prioritize which antecedent conditions will be targeted. Strategies are then developed to target the prioritized antecedent conditions. Linking strategies to antecedent conditions ensures the organization does not engage in activity traps: feel good activities that will not lead to desired changes in the endstate. Once a strategy is defined then performance measures and indicators are sought to track progress toward and impact on the desired endstate.

Situational analysis

When developing strategies, analysis of the organization and its environment as it is at the moment and how it may develop in the future, is important. The analysis has to be executed at an internal level as well as an external level to identify all opportunities and threats of the external environment as well as the strengths and weaknesses of the organizations.

There are several factors to assess in the external situation analysis:

1. Markets (customers)
2. Competition
3. Technology
4. Supplier markets
5. Labor markets
6. The economy
7. The regulatory environment

It is rare to find all seven of these factors having critical importance. It is also uncommon to find that the first two - markets and competition - are not of critical importance. (Bradford "External Situation - What to Consider")^[3]

Analysis of the external environment normally focuses on the customer. Management should be visionary in formulating customer strategy, and should do so by thinking about market environment shifts, how these could impact customer sets, and whether those customer sets are the ones the company wishes to serve.

Analysis of the competitive environment is also performed, many times based on the framework suggested by Michael Porter.

With regard to market planning specifically, researchers have recommended a series of action steps or guidelines in accordance to which market planners should plan.^[4]

Goals, objectives and targets

Strategic planning is a very important business activity. It is also important in the public sector areas such as education. It is practiced widely informally and formally. Strategic planning and decision processes should end with objectives and a roadmap of ways to achieve them. The goal of strategic planning mechanisms like formal planning is to increase specificity in business operation, especially when long-term and high-stake activities are involved.

One of the core goals when drafting a strategic plan is to develop it in a way that is easily translatable into action plans. Most strategic plans address high level initiatives and overarching goals, but don't get articulated (translated) into day-to-day projects and tasks that will be required to achieve the plan. Terminology or word choice, as well as the level a plan is written, are both examples of easy ways to fail at translating your strategic plan in a way that makes sense and is executable to others. Often, plans are filled with conceptual terms which don't tie into day-to-day realities for the staff expected to carry out the plan.

The following terms have been used in strategic planning: desired end states, plans, policies, goals, objectives, strategies, tactics and actions. Definitions vary, overlap and fail to achieve clarity. The most common of these concepts are specific, time bound statements of intended future results and general and continuing statements of intended future results, which most models refer to as either goals or objectives (sometimes interchangeably).

One model of organizing objectives uses hierarchies. The items listed above may be organized in a hierarchy of means and ends and **numbered** as follows: Top Rank Objective (TRO), Second Rank Objective, Third Rank Objective, etc. From any rank, the objective in a lower rank answers to the question "How?" and the objective in a higher rank answers to the question "Why?" The exception is the Top Rank Objective (TRO): there is no answer to the "Why?" question. That is how the TRO is defined.

People typically have several goals at the same time. "Goal congruency" refers to how well the goals combine with each other. Does goal A appear compatible with goal B? Do they fit together to form a unified strategy? "Goal hierarchy" consists of the nesting of one or more goals within other goal(s).

One approach recommends having short-term goals, medium-term goals, and long-term goals. In this model, one can expect to attain short-term goals fairly easily: they stand just slightly above one's reach. At the other extreme, long-term goals appear very difficult, almost impossible to attain. Strategic management jargon sometimes refers to "Big Hairy Audacious Goals" (BHAGs) in this context. Using one goal as a stepping-stone to the next involves **goal sequencing**. A person or group starts by attaining the easy short-term goals, then steps up to the medium-term, then to the long-term goals. Goal sequencing can create a "goal stairway". In an organizational setting, the organization may co-ordinate goals so that they do not conflict with each other. The goals of one part of the organization should mesh compatibly with those of other parts of the organization.

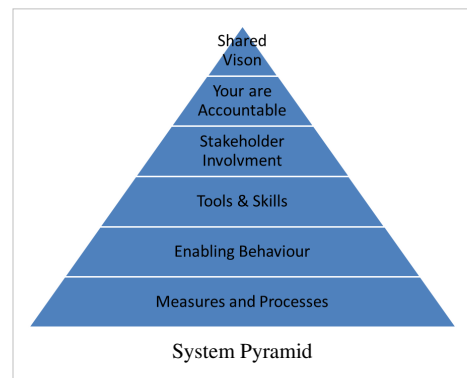
Business analysis techniques

Various business analysis techniques can be used in strategic planning, including SWOT analysis, PEST analysis, STEER analysis, and EPISTEL (see above).

SYSTEM:

Successful and sustainable transformation efforts require leaders who know how to manage change. At the simplest level, managing change means:

- Knowing what you want to accomplish and creating a compelling vision that motivates others
- Understand stakeholders and communicating with them early, consistently and often
- Managing the varying levels of support and resistance that will inevitably emerge in response to any change
- Change Leadership is a skillset that is required throughout any deployment, from planning and executing to sustaining improvements.
- Change Leadership is essential for both high level executives and program leaders, who are responsible for setting the vision, communicate the vision and make the changes happen.



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New business development

New business development concerns all the activities involved in realizing new business opportunities, including product or service design, business model design, and marketing. When splitting business development into two parts, we have: 'business' and 'development'. The first things that come into mind when looking at *business* are: economics, finance, managerial activities, competition, prices, marketing, etc. All of these keywords are related to risk and entrepreneurship and clearly indicate the primary scope of the term 'business development'. *Development* is very abstract and can be linked with some of the following keywords: technological improvement, cost reduction, general welfare, improved relations, movement in a (positive) direction, etc.

In the traditional definition of Business development, Business Development is mostly seen as growing an enterprise, with a number of techniques. The mentioned techniques differ, but in fact all of them are about traditional marketing. The main question in these issues is: how to find, reach and approach customers and how to make/keep them satisfied, possibly with new products. (Kotler, 2006) Since this definition is limited and lacks some essential factors in business developing, a complete new definition of Business Development will be introduced. Of course, the theory on "traditional" marketing is still correct and can be adopted from the old definition. When supplying a solution, it is important to focus on the total offering you give instead of only focusing on the product or service. An offering is a package consisting of different proportions of physical product, service, advice, delivery and the costs, including price that are involved in using it. Hereby the advice, adaptation to the customer and the costs are the most important factors to get the right combination within the offering. (Ford et al., 2006; Hakansson et al., 2004) Drawing on contingency theory, an idea central to new business development is that different product-market-technology combinations can require different marketing strategies and business models to make them a success (Tidd et al., 2005). To chart the factors that are involved and create synergy between them, new business development draws heavily upon the fields of technology and business networks. The new business development process is to recognize chances and opportunities in a fast changing technological environment. Often uncertainty arises because of new technology and their new markets.

Technology

Innovative technology provide important opportunities for new business development. For a company it is important to keep products and processes up to date, to stay competitive (Ford et al., 2006). Continuous investment in innovation for both products and processes makes it more difficult for others to offer a large technological functionality advantage (Schilling, 2003). Many companies need technological development to stay competitive. Technological development can occur through making decisions about acquiring, exploiting and managing technologies. These decisions should be made by involving the research and development staff, purchasing staff and marketers. (Ford et al., 2006) The customers are also important (Schilling, 2003; Ford et al., 2006).

Furthermore technology can be analyzed by the concept/framework of value configuration as introduced by Stabell Fjedstad (1998). The framework consists of three value configurations, which are an extension of the value chain model by Porter: the value chain (transformation of inputs in products), the value shop (solving customer problems) and the value network (linking customers). These configurations overcome some of the issues with the traditional value chain model, which is only helpful for traditional manufacturing companies. In practice firms are not pure instances of a single distinct value configuration, multiple combinations of configurations can be found within one firm (Stabell & Fjeldstad 1998).

The value creation process can also be understood from the perspective of Schilling. Schilling talks about value in the sense of technological functionality, installed base and complementary goods of a product. (Schilling, 2003). It may be clear that technology plays an important role in this value creation process, and in general contributes to the process of renewing the match between problem and solution.

Business networks

Traditional marketing is usually based on economic models (Williamson, 1975). In those pure economic models there is no room for negotiations and special treatments for different companies. A technological environment however can be very uncertain and therefore competitors have to rely heavily on their business networks. It is then that special treatments and negotiations are necessary.

It is important to recognize the effect social relations have on economic action, including business development (Ford et al., 2006). Granovetter also argues that social relations in a network lead to trust between partners, an important factor for stable development in a dynamic environment. By focusing on these new activities, it becomes difficult to keep every activity up-to-date and to maintain the competitive advantage (Ford et al., 2006). Companies therefore increasingly concentrate their investment and their activities on only a few activities which they believe to be their core business, otherwise their competitive advantage is easily lost. Because they concentrate on just a few activities, they need business relations for the other activities (Ford et al., 2006).

Relationships are usually based on resource ties, activity links and/or actor bonds (Ford et al., 2006). A company should therefore analyze their firm itself, their relationships and their business networks in terms of activities, actors and resources. In this way, a company can determine where there are new opportunities for relationships and where resources, technologies and/or skills can be developed, integrated or exploited from other companies (Ford et al., 2006). In this way, business development can be established with help of this business network.

Nowadays, marketing is about the exchange of heterogeneous resources between dynamic, cooperating partners in network-like structures (Hakansson et al., 2004). It is about relationships, not about selling products. So, business marketers should be busy finding, developing and managing of relationships within the complex network that surrounds them (Ford et al., 2006). Blois (2004) provides three ways in which a firm can evolve from market to network mechanism. These are entrepreneurial alertness (being alert to value-creating opportunities), path dependence (historical events cause solutions to problems and become "locked in") and replaceability (irreplaceable contributors get much attention of others trying to influence them).

It is still questionable to what extent these networks are involved by social relations, since the mentioned authors don't agree on this. Therefore, enterprises have to cope with the problem of how to maintain their network contacts.

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