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## PLANTING THE SEEDS OF EFFECTIVE ENTREPRENEURSHIP BY TEACHING RISK, ADVISING, AND DESIGN THROUGH GROWTH.

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### **Abstract**

In order to be successful, new entrepreneurs must learn to know their tolerance for risk, the ways to grow a business, and how to adapt their organization's structure for success. This study explores several relevant teaching methods for helping entrepreneurship students learn essential concepts and skills. Recommended teaching techniques include: Using realistic risk assessments that include having students address what their personal consequences of failure might be, development of individual business plans to mimic the commitment and ownership experience by entrepreneurs, accessing advisors while creating their business plans, and simulating rapid growth and consolidation as a platform for learning key concepts of organizational structure, design and change practices. The practical and vivid nature of these teaching techniques contributes to their potential for retention and use by students in their future entrepreneurial organizations.

*Keywords:* Teaching, Entrepreneurial Risk, Growth, Structure, Organizational Design, Change Management, Organization Theory, Business Planning.

## Introduction

An important goal of entrepreneurship educators and public policy officials in many countries has been creating more entrepreneurs with better skills and greater knowledge of new venture creation (Alvord, Brown, & Letts, 2004). Training undergraduate and graduate students with limited career experience to take on the opportunities and challenges of entrepreneurship has become an important part of many business schools throughout the world. Success in business education has been mixed with key researchers questioning the methodology and subject matter that are addressed in business schools. Concerns have been raised that business schools may not be teaching the disciplines needed by students, most notably ethics, nor using effective teaching methodologies (Boyle, 2004; Pfeffer & Fong, 2002; Rynes, Trank, Lawson & Ilies, 2003).

In the area of entrepreneurship, there has been concern that teaching and textbooks have not adequately addressed the needs of future entrepreneurs (Edelman, Manolova, & Brush, 2008). Arguments have been made that teaching methods need to reflect more of what an entrepreneur faces in the difficult environment of venture formation (Honig, 2004).

This article examines an innovative use of business planning techniques in training potential entrepreneurs. These techniques adapt the business planning model familiar to many entrepreneurship educators in several distinct ways. Concerns raised by entrepreneurship educators are reflected in the adapted training methods with a key goal of providing students with vivid learning lessons for their future endeavors.

## Specific teaching techniques

While there are a number of structural issues that encourage people to become entrepreneurs, there are also many roadblocks to their entrepreneurial plans. These roadblocks, while difficult to overcome, also serve an important purpose in forming a hurdle. Weak or unmotivated entrepreneurs are screened out of the process, leaving more market space for better qualified, dedicated and innovative entrepreneurs. The key learning tool in this proposed method of instruction is the business plan. Business planning is an important part of many entrepreneurship training programs and university classes (Delmar & Shane, 2003). In the approach described in below, business planning proves to be a versatile and vivid way of illustrating the challenges of entrepreneurship.

In most classes, graduate students propose businesses that are software suppliers or provide some intermediary manufacturing or service activity that improves on current market offerings. Undergraduate students typically propose businesses that involve some

form of retail operation such as a restaurant, club, or music retailer. Other common business interests involve creating sports facilities, professional sports franchises and exercise/fitness complexes. Students from families that have businesses often expand the family business into a new location or format. Few start truly new businesses, and in the first round of planning, there is often minimal innovation in the business.

Part of the class time is devoted each week to working with their advisor teams, this advising activity is designed so that seeking advice and opinion from others becomes second nature to the entrepreneurial student. In addition, during the second half of the course, students advisory team members take their individual businesses and form a consolidated business that incorporates all of the individual student business plans in their team while assuming growth of at least a factor of 100 times their original projection (100 locations, 100 times existing production and sales).

## *Risk, failure and its consequences*

Perhaps the most difficult, yet essential, obstacle to overcome is that of a willingness to accept risk and the consequences of venture failure. Start-up conditions vary across nations and industries, and are influenced by cultural attitudes toward risk as well as business legalities (Kantis, Ishida & Komori, 2002). Addressing the potential entrepreneur's attitude toward risk is essential to help them cope on an individual and personal level with the risk of launching a new venture. Educators play an essential role in helping future entrepreneurs assess the likelihood of failure and its potential consequences. A common way to address the issue of risky start-ups is to quote the stark statistics that show survival rates of what were once newly founded businesses after one and two-years of time has passed. Simply reviewing the statistics is not gripping enough to impress upon students the commitment necessary to overcome those odds. Nor do statistics serve to help students understand and feel how devastating failure or invigorating success might be in their particular circumstances.

The fear of failure, the level of embarrassment, and potential punishment for failure within a particular culture combine to either encourage entrepreneurship or to discourage it. For example, mid-career students at the University of California – Irvine expected to fail at some point and lose their financial investment, or even their homes, before they would have a successful business. Some had already tried to launch a business and failed, and were in the process of trying again.

While they knew there would be consequences to failure, there was a willingness to take on the risk because they were confident that they could recover. This contrasted dramatically to the attitude of Chilean MBA students, who

expressed concern over maintaining their current positions and feared that a failed business venture would make returning to a corporate career difficult because of the social stigma of having failed. The question for educators becomes how do we prepare students to take on the risk of failure, especially in situations where the national culture and/or their profession provide significant negative consequences for failure?

### *Understanding risk and ownership*

In addressing this issue, educators must first acknowledge that they will not be able to change society's view of failure. Students in the US tend to underestimate the consequences that they will face focusing mainly on the financial consequences and ignoring effects on their personal relationships. In several South American countries, potential entrepreneurs faced difficult consequences if they failed and tended to exaggerate the difficulty of recovering from failure (Peru University, 2006; Argentina University, 2006).

Educators can help future entrepreneurs appreciate the effects of a possible failure through several specific steps. One which I have used in classes is to have students clearly describe what they knew about organizations that had failed and what happened to the organization's leaders. Often they know people personally whose businesses had failed. Rarely have students considered what a similar experience might mean to them personally; their thinking has always been rather abstract.

To help students experience success and failure in a vivid way, as part of their business planning efforts they can create detailed exit strategies for several scenarios: strong success, moderate success and failure in less than 12 months from start-up. As part of the failure scenario, students address what they will lose in terms of financial resources. They also explain what they will have to give up in material terms due to the losses (home, children's education, vacations). Finally, students address how they think their personal relationships will change due to failure.

The advantage of this process is that the student is able to see what success will mean in financial terms. Often it brings less than the future entrepreneur envisioned, usually due to a tendency to overestimate profits and discount taxes on the profits that are made. Challenges of such a process include dealing with students discouraged from becoming entrepreneurs due to the vivid picture of the difficulties involved, the real risks of financial losses, as well as changes to longstanding relationships. Although discouraging entrepreneurs is not a popular position, as entrepreneurship educators we should err on the side of caution and "do no harm". Bringing a strong dose of reality into the business planning process helps student entrepreneurs understand their risk tolerance levels. Those who cannot tolerate the risk of failure ultimately benefit by

not wasting their time studying and organizing a new venture that may bring them personal and financial burdens they cannot bear. Those who can tolerate the risk learn to work hard and plan well to minimize the likelihood of failure.

### *Emphasizing ownership through individual business plans*

Becoming an entrepreneur involves a great deal of risk, but it also can require a tremendous sacrifice of personal time and dedication and passion. To make this point in class, rather than require team-based projects, students must develop their own business plan proposal. From the first day of class, emphasis on the ownership of the idea for the venture, its innovativeness, and its potential success rest with each student. This is very motivating to students who typically do not have to take ownership of their team projects and many are surprised and ask repeatedly "Do you mean I can do anything? Any business I want?" Guidelines encourage formation of innovative businesses in any *legal* endeavor.

A number of students will struggle with this freedom of choice because they often only take support roles in projects and do not really know how to deal with the responsibility of being the entrepreneur moving the organization forward, yet they usually warm to the idea of doing their own business. Eventually they guard their independence and comment that they are glad they did their own plan because the amount of energy and effort would have been difficult to summon for someone else's project. Students who start the project with an indifferent attitude often become highly motivated by being solely responsible for their own plan. They often acquire deep expertise by planning their chosen organizations in great detail. Having to determine a unique or innovative way to serve their clientele also improves students' abilities to recognize opportunity, an important skill for entrepreneurs (Phillips & Tracey, 2007).

In large classes, individual projects become problematic due to a demanding grading process. Sacrificing the *individualized* experience of developing a business plan should not be done if at all possible. If necessary, however, one teaching modification that can help reduce the number of plans in a large class of students is to have each student develop an initial idea and then have pairs of students with similar ideas form a partnership. This preserves some of the ownership aspect that individual plans have, yet reduces the complexity of the course for the instructor.

Too much emphasis on the individual can be detrimental to the education of the entrepreneur, because organizations do not exist in isolation. As educators we must be mindful that decision-making by a single individual is sub-optimal in many cases. Organizations are

trending toward team structures and to encourage growth, governments often encourage larger and more innovative organizations when possible. In the entrepreneurial process, the formation of an entrepreneurial team embodies these concepts. However, in practical terms in the class each student forms their own individual venture. To address this specifically in a class with individual business plans, students are organized into teams of 4 or 5 and act as each others' boards of advisors.

### *Using 'advisory' teams*

In the first three weeks, students explain their initial business ideas and focus on defining their likely customer base and competitive advantage. The student advisory teams define behavioral standards for team members in the role of business advisors. Students then develop a short summary presentation of their business idea (an expanded version of the typical 'elevator speech' used to attract venture capital) by pitching their initial ideas to the class. Their classmates ask brief questions and provide written feedback. The team of advisors then engages in a brainstorming session to deal with specific issues identified in the 'elevator speech' presentation.

Students' benefit from this process in a number of ways: First, they learn first-hand the difficulty in identifying innovative business ideas that will appeal to buyers in ways that are unique in the marketplace. Struggling with uniqueness is often new to students, who are primarily programmed to perform in expected ways and within norms that support traditional grading evaluations. They are inspired to be more innovative in their business because they choose what business proposal they will propose and they are ultimately responsible for the proposition, just as the entrepreneur is responsible for a start-up business (Phillips & Tracey, 2007).

At the same time students are struggling with innovation issues, they also learn the value of tapping the creativity of their board of advisors. Students learn the important roles advisors can play in the early stages of developing their start-up businesses. The goal of this is to help students value seeking advice and identifying competent advisors to put on their venture teams in the future.

To make this advising phase most effective, it is crucial that students see good examples of incisive criticism and developmental comments. To do this, the instructor should sit in with teams as they discuss business plans and use student comments as examples to the class in open discussion following the brainstorming session and presentations. Other sources of good examples of useful critiques are interviews with venture capitalists (VCs) and descriptions of business plans that participated in business plan competitions. VCs are skilled in identifying a lack of

innovation or uniqueness in a business which seems to be hard for many students to grasp.

Ironically it is easy for students and entrepreneurs to assume that if they offer a product or service, buyers will come and buy. But that assumption can be fatal to a new business so instructors must revisit the issue of competitive advantage. To practice, during the next 3 or 4 weeks have students and their advisors work to improve the uniqueness of their offerings while solving the usual organizational problems of determining location, facility, supply, hiring, and profitability of their business.

### *Teaching organization design, theory and change using growth, consolidation and change.*

In educating potential entrepreneurs, there is often an emphasis on practical skills in functional areas and it is often difficult for instructors to address the more abstract macro-level issues that new ventures face when they grow. Students and business planning materials focus on the start-up phase of new ventures and for good reason, it is a very risky phase and if it is unsuccessful, none of the rest matters. However, if we as educators do not find ways to help future entrepreneurs address these macro-level issues then they will be poorly prepared to deal with the success for which we hopefully are preparing them to experience.

As already illustrated above, the business plan offers a rich platform for learning entrepreneurship. Some macro-level concepts are difficult to illustrate in a vivid manner in a classroom setting. However, students often propose organizations that are small businesses that do not lend themselves to structural issues. Training entrepreneurs how to adapt as the enterprise grows makes a great deal of sense but has some practical limitation, especially in terms of student retention of the key concepts until faced in the future with the need to manage growth.

To address this as educators, we need a vivid and meaningful way of communicating the rather abstract concepts of organization theory and design. Key concepts that entrepreneurs need from these two areas include: Competitive strategy, resource-based view of strategy, generic strategies, five-forces analysis, transaction costs, agency theory, population ecology, resource dependence, isomorphism, organizational structure with an emphasis on team-based structures, strategic alliances and networks, technology and structure, organizational change and evaluation (including a balanced scorecard approach). By using a vivid business planning manipulation, students have a memorable background on which to practice the concepts and related skills for the topics listed above.

To address macro-level issues and change management, in the second half of the class student advisory teams combine their individual business plans into a multi-divisional organization. First the teams must identify potential synergies within the meta-business, such

as pools of common customers, similar location needs, common suppliers or internalization opportunities (ability to supply each other). The motivation for this manipulation is to set up thinking about how to structure a much larger and more diversified business such as the entrepreneur might experience in the future. Students and entrepreneurs often struggle with conceptual material without clear application which makes acquiring organizational design skills a challenge. As students develop their meta-business plan they practice with the concepts and theories that are more related to larger organizations than start-ups.

While studying the principles of structuring organizations, the students then develop a structure for their combined businesses. This can be done initially using Post-it® notes on a large sheet of cardboard. Physically arranging the different parts of each individual business into a combined plan illustrates concepts such as line and staff authority, corporate-level synergies, multiple-division structure options and potential outlier functions that can be spun-off, outsourced or consolidated. Students quickly see how having functional divisions in a multi-business organization becomes redundant and expensive.

For the next phase of the integrated plan, students assume that their combined organization grows to 100 times its original size or to 100 different locations. The exact amount of growth is not important as long as it is substantial. Further complexity can be added by requiring that the business plan must now incorporate international expansion. Students determine the methods of communication to be used in the now very complex organization. As the distance from their chosen positions (usually they opt to be CEOs of divisions) grows, the instructor has the opportunity to confront the issues of how operations will have to change.

This is an excellent opportunity to confront resistance to change in the original organizations as they move to the much larger and more complex multi-business format. Students see that they will have to plan for change and how to overcome that resistance. In addition, performance evaluation across the divisions can be addressed through the balanced scorecard approach. As they determine what their procedures will be, students begin to see what they will need to consider as they become successful and have to manage a more complex organizations. Future entrepreneurs with this background in the complexity of organizational growth and change may feel more confident in deciding if they can manage the organization as it grows or if they should exit and let others manage it.

Without these skills, the successful entrepreneur often opts to restrict growth so that the business remains manageable which will cost increased sales opportunities. As entrepreneurship educators in many places have experienced, entrepreneurs are often self-limiting. The “entrepreneur of necessity” (Peru University, 2006)

deliberately limits the growth of the business, leading to formation of smaller businesses that provide only a single job for the entrepreneur. Promoting entrepreneurship only to have it limited in this way is expensive for society because many resources are used to educate the entrepreneur but few jobs are created. Risk-averse entrepreneurs, or those facing structural penalties due to complicated incorporation procedures, and confiscatory taxation regimes often stay small to may remain ‘informal’ and off of tax rolls, and leave little room for expansion of employment and sales (Peru University, 2006; Argentina University, 2006; Brazil CMP SOC, 2006).

### *The macro-plan as an occasion to develop broader knowledge*

Combining the original businesses required the team members to broaden their business knowledge to multiple businesses in several industries. As former advisors, now turned partners, they bear the consequences for the recommendations they may have made (or failed to make) as part of the board of advisors for the individual businesses. Some variations of this structure can also yield strong learning results. For example, instructors may choose to re-group student teams by teaming similar businesses or industries. If the instructor emphasizes a competitive atmosphere in the course and wants plans that are deeply elaborated, grouping students within industries or with similar business plans will facilitate depth of learning and application.

On the other hand, a diverse group of organizations emphasizes the challenges of merging diverse businesses into a coherent organization and sets up rich discussions of structural changes and performance evaluation of subsidiaries or divisions in the meta-organization. In their original business plan, each student proposed a structure for operating their own individual business. A key task in developing the meta-plan is for the individual business structures to be revised into a new structure. Students then present the new structure with justification that it will satisfy the needs of the meta-organization. As part of this presentation, students explain synergies they have identified and how they contribute to the strategic goals of the organization. Often students identify that they need to internalize operations of a supplier through acquisition or alliance formation (or that they will need to outsource some functions as the meta-business will focus, for example, only on retailing rather than both manufacturing and retailing).

In terms of making an impact on future entrepreneurs, at the end of the first phase of the class (7 weeks or 14 class sessions) students are confident that they can keep control of their individual venture but are usually discouraged by their financial and operating projections that inevitably show a lack of projected profits. However, by

combining ventures and complicating their situations they are forced out of their comfort-zone and have to confront actively the fact that their existing organization cannot survive and must change.

In the second half of the semester, students move away from the traditional financially oriented planning activities and focus on developing their multi-business plan. This portion of the course emphasizes learning how the meta-organization could be structured and operated. They have to determine how it will change, how their changes will address the issues identified for the meta-organization, how they will implement those issues and overcome resistance to change and measure performance. By having to confront the differing and often competing priorities in each part of the business, entrepreneurship students learn that they must develop multi-faceted evaluation methods to understand the new organization's performance. By addressing this process as part of their planning efforts, students may be more willing to adapt their performance criteria early in the growth process, avoiding outmoded measures that can hurt an organization by mis-aligning or failing to align incentives, responsibilities, and results.

## Conclusion

If we as entrepreneurship educators can perform in a more effective manner, we will enable our students to play important roles in changing our society through entrepreneurship (Alvord, Brown, & Letts, 2004). Students will be able to be more effective in choosing to pursue entrepreneurial ventures by improving the experiential nature of teaching (Honig, 2004). Better entrepreneurs will improve the nature, quantity and quality of businesses as well as their survival and growth. Specifically, this paper recommends the following teaching techniques:

- Make risk assessment a personal experience
- Create ownership through individual business plans rather than team-based ideas
- Employ a team of business advisors to improve the plan
- Confronting organizational structure, design, growth and change issues using the complications presented by merging multiple plans into a single meta-organization.

While these recommendations only address several of the many topics needed for starting and managing a new venture, the topics are subjects that can be the most problematic for students to grasp and retain. This teaching approach reflects a desire to confront students with the need to address the multiple areas or bricolage (Baker & Nelson, 2005) that entrepreneurs must use to advance their organizations. The methods proposed move away from the traditional linear approach to business planning to an

approach that more closely resembles a rich simulation called for by entrepreneurship education reformers (Honig, 2004). I hope that these teaching techniques are useful and serve to promote entrepreneurship success in the future.

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