

# New Venture Creation in the Realm of Practicable Choice

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## *Abstract*

*The entrepreneurial event is a contingency from which entrepreneurial behaviour precipitates. It is a temporal confluence among some external cue that implies an extant, potential, or possible opportunity; a perception of the cue implications; and, an entrepreneurial response. It begins with recognizing and evaluating an opportunity and ends with a venture concept and entity to harness that opportunity (Stevenson, Roberts & Grousbeck, 1989). New venture creation is, thus, the product of a decision process. And, these decisions are often fraught with biases (Wickham, 2003).*

*This raises an important question. What conditions dictate practicable reasons for starting a new venture? Heretofore, the corpus of new venture contributions has focused on the variables that seem associated with launch decisions. Conspicuously absent is an examination of the decisions themselves and the conditions that dictate if they reflect objectively sound judgment. This paper explores these decisions through the lenses of reality, feasibility, and desirability.*

**Keywords:** *new venture, entrepreneur, decision making, SME, business failure*

**JEL Classification:** M13, B25

## **Background**

An *enterprise of a business nature* was first labeled a *venture* around 1584 (OEM, 2001). Once the term was established, it languished for about 170 years until Richard Cantillon (1755) endeavored to understand how such ventures might be founded. In the process of disciplined inquiry, Cantillon simultaneously, and inexorably, linked *new venture formation* to what he identified as *entrepreneurship*. He, and those who followed in his wake, envisioned entrepreneurship as an economic institution in which some individuals are induced to hazard uncertainty and create value for the promise of handsome personal gains (Cantillon, 1755). By combining factors of production secured from others (Say, 1803) and selling their produce, they pay the economic rents and retain the residuals as profits (Liggio, 1983). Implicit in the process is the notion that the greater the uncertainty, the greater the profit potential must be for the new venture to be founded.

Interestingly, little of the mainstream entrepreneurship literature written since 1960 makes much mention of new venture creation (Bird, 1992; Byers, Krist & Sullivan, 1997; Covin & Kuratko, 2008; DeVries, 1980; Folsom, 1987; McClelland, 1961; Pinchot, 1985; Zahara & George, 2002). On the other hand, little of the new venture literature written over the same period omits the key role played by the institution of entrepreneurship. Ronstadt (1984) offers some insight into this schism by admonishing that the primary *creation* parented by entrepreneurship is not new ventures, products, or services, but, instead, “incremental wealth” and means for achieving it.

Another contemporary split between the new venture and entrepreneurship communities devolves upon the quest for a concise, operational, definition. Over the past 50 years, the boundaries of entrepreneurship have become progressively more amorphous and the definitions more inclusive. In 1978, the Strategic Planning Institute (p. 1-2) provided specific guidance for defining a new venture:

1. An independent entity.
2. A new profit center within an established business.
3. A joint venture that satisfies the following criteria:
  - a. Its founders must acquire expertise in products, process, market and/or technology;
  - b. Results are expected beyond the year in which the investment is made;
  - c. It is considered a new market entrant by its competitors;
  - d. It is considered a new source of supply by its potential customers.

New venture research and theorizing have thus, more or less, embraced the original, economic, definition of entrepreneurship and have continued to enhance and refine it. Contributions have concerned themselves with the ideation, creation and launch issues/processes associated with new ventures and accede to the field of management once the venture is established. Entrepreneurship has, concurrently, become a psycho-social-strategic-leadership-humanitarian-political-international-agency-organizational creature bearing little semblance to its economic roots. Its life span is purported to be infinite, clearly transcending the founding process. In the final analysis, the two, originally-related, fields have metamorphosed into two distinct disciplines.

The focus of this study follows the *new venture creation* stream of thought. More specifically, the following discussion flows from the economic theories of entrepreneurship and seeks to identify the link between the new venture launch decision and those conditions that dictate its practicability. As an aside, the term *practicable* - capable but untried - is used here as it seems a more accurate descriptor of the new venture creation challenge than the expression *practical* - tried, tested, and true.

### The 3-D Model: Defining the Realm of Practicable Choice

The success potential of any decision is bounded by three conditions: 1) *reality* - objective possibility, 2) *feasibility* - the abilities and capacities of the actor, and 3) *desirability* - the attractiveness or aversiveness of the proposed action (Desman & Brawley, 1997). Natural, institutional, and market conditions dictate reality. That an option may be realistic, however, does not mean that it is “doable.” The individual’s ability to embrace an option and see it to fruition depends on his other obligations, assets, talents, and energy. Finally, the individual’s willingness to undertake the action with the requisite level of commitment will impact the final outcome. A half-baked effort will thwart the most promising of endeavors. Together, *reality*, *feasibility*, and *desirability*, in that order, represent the three dimensions to which any practicable choice must conform (see Exhibit 1).

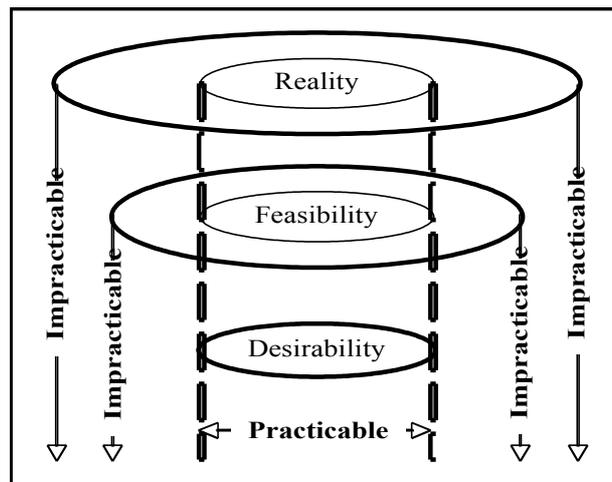


Exhibit 1 The 3-D Model: The Realm of Practicable Choice

In an attempt to construct a model for describing new venture creation, Gartner (1983) undertook an extensive review of the literature and concluded four families of variables that influence the “*phenomenon*.” His conceptual framework consisted of individual tendencies, environmental composition and dynamics, organization strategies and practices, and the entrepreneurial process. About the only subject covered in the literature that was not included in his study is the relationship between technology and new venture creation (Shane, 2009). This is a reasonable omission considering that the subject was not broached with any level of intensity until a decade later. Had he considered it, it likely would have been included as an organizational variable.

Gartner’s contribution holds two significant implications for this study. First, his schema of environment, organization, and individual aligns nicely with the 3-D model’s reality, feasibility, and desirability. Second, the contributions cited

in his work suggest previous research has focused principally on desirability inducements - entrepreneurial spirit, resource availability, low entry barriers, organizational strengths, etc. - and paid little attention to the attending reality and feasibility factors. The not-so-subtle implication here is that individuals may be tempted to create new ventures in response to some cues in a contingency without regard for the practicability of their choices. Their decision processes begin and end with *desirability* (in some cases *reality* is considered); necessary conditions are simply assumed to represent sufficient conditions.

### **Practicable New Venture Birth Stimuli**

If the model in Exhibit 1 is approached in ascending order sheer novelty or attractiveness might provide a sufficient inducement to spawn a new venture. A real estate developer locates a source of cheap financing, an aspiring restaurateur finds an old family recipe, a hobbyist masters a craft and suddenly a new strip mall, café, or production facility appears. The upshot? According to the U.S. Bureau of the Census for the most recent period available (Census, 2005), 768,420 new businesses are born. In the same period, 675,218 businesses that existed the year before perished. Over 75% of the enterprises in each category were SMEs.

Certainly not all business deaths can be attributed to faulty founding assumptions, but the mortality numbers are alarming. The 1.4% net enterprise growth rate exceeds the population growth rate by 0.5%. If the number of businesses is growing faster than the population in general - and that includes both net births and immigration - and the number of business deaths is 88% of business births, it can be reasonably concluded that new venture creation is driven by forces other than increases in demand and the cause of business deaths exceed those attributable to natural forces (obsolescence, death or retirement of owners, loss of interest, business failure of suppliers, etc.). Might some venture founders “put the cart before the horse” and suffer the consequences? Weick (1995) suggests this is exactly what happens. Individuals and organizations often *intend action and then create meaning* to justify the action to which they have committed or *create meaning to explain actions* already taken.

If the model in Exhibit 1 is approached in descending order the results might be quite different. Certainly doing so will not guarantee survival and success, but it does have the potential for avoiding certain failure. The discussion now turns to the *realistic* bases for new venture creation.

### **Practicable Reality =f(External Contextual Conditions)**

A review of the literature suggests that there are only three *realistic* reasons for new venture creation: 1) satisfying a latent or unfulfilled need (Cole, 1959), 2) improving an existing satisfier (Schumpeter, 1911), or 3) satisfying under-filled demand (Desman, 2007). Respectively, the creativity engines powering each reason are *invention*, *innovation* and *adaptation*.

Arthur Cole (1959) opined that creativity could take the form of

identifying some latent or unfulfilled need and then combining, creating, promoting, or building something to satisfy that need. He envisioned the entrepreneur as a *visionary, creative, opportunity seeker*. His take on a new venture fits nicely with Cantillon's idea that entrepreneurs "hazard uncertainty." Although much of the entrepreneurship literature addresses the issue of risk, there is considerable difference between *risk* and *uncertainty*. Risk is probabilistic and probability can only be calculated from prior experiences. Uncertainty has no such luxury and the absence of precedence suggests that the enterprise is entirely *new*. Consequently, Cole's entrepreneur and his new venture represent the epitome of new venture creation in its most pure form. It is *new* with a capital "n." It is the product of invention.

Joseph Schumpeter arrived at new venture creation by an alternative route. According to Schumpeter (1911, 1942), if firms enjoy some degree of monopoly power, derived from size and past achievement, they will be disposed to pursue equilibrium and profit maximization. Consequently, at some point, economic growth will ebb. Market dominance by large firms can only be disrupted by radical innovation - new products, methods, materials, markets, input sources, transportation methods, management techniques, financial instruments, and legal maneuvers. On the one hand, such innovation would reduce the value of the established companies, but on the other, it would foster a new round of economic growth. Key to Schumpeter's take on sustained, long-term economic growth is, thus, the entry of the entrepreneur who is a *radical, innovative, change maker* and a new venture that represents an improvement over its predecessors.

The third realistic reason for pursuing a new venture generally devolves upon developmental patterns inherent in industry life cycles. There are identifiable shifts within the "growth" stage in the classical four-stage life cycle model. In the early and middle growth stage, once the product "takes off," industry capacity is insufficient to keep up with demand. Thus, it is during this period that new entrants are attracted by potential profits (Desman, 2007). Similar to Cole's thesis, new venture creation at this juncture is initiated to "soak up" unfilled demand. In contrast to Cole, the new venture is an *adaptation* to extant market conditions versus an unprecedented leap of faith. The *entrepreneurial event* may take one of two forms: 1) the infant industry has insufficient supply capacity, or 2) the youthful industry has yet to saturate all market niches (e.g. geographical locations or special applications).

These latter conditions can also result from *artificial* or *natural* barriers to access. Restrictive public policy or conspiratorial competitive practices may create under-supply or market voids in much the same manner as life cycle dynamics. In such cases, the new venture response will take the form of black, grey, or illicit market activities. Where the conditions arise as the result of natural phenomena - drought, flood or seismic activity - the new venture may be founded on providing adaptive distribution mechanisms or substitute satisfiers.

All three birth stimuli cited above are related to market demand and whether it is unsatisfied, might be better satisfied, or is insufficiently satisfied. Lest

the argument be over simplified, however, it should be noted that “satisfaction” is a function of the consumer not the producer. Consequently, the entrepreneurial challenge may consist of something greater than simply “providing more.” As noted above, a satisfier must be obtainable before satisfaction can be achieved. Invention, innovation, and adaptation, therefore, can effectively increase supply by: 1) providing additional production capacity, 2) improving access, or 3) developing alternative satisfiers. Irrespective of the route taken, however, if one of the three demand conditions discussed does not exist, it is unlikely that launching a new venture is a practicable idea. If one or several do exist, the second test relates to one’s ability to seize the opportunity. This, of course, is a matter of *feasibility*.

### **Practicable Feasibility =f(Organization Abilities and Capacities)**

Coincidentally, three conditions also appear to bind the organization’s feasibility envelope: 1) sufficient hard capital, 2) sufficient *firm capital*, and 3) enduring proprietary assets. Depending on the nature of the market opportunity one or several of these elements must be exploitable to create a new venture with any hope of success.

Hard capital is the most obvious and discussed of all the feasibility factors. It consists of the *physical* and *financial* resources available to the enterprise. Enough has been written about the importance of sufficient plant, equipment, credit and cash to eclipse any discussion that may be undertaken here. Suffice it to say that the availability of sufficient hard capital - either in hand or having access to it - is a limiting factor no matter what the ambition. *Sufficiency* is dictated by the nature and scale of the proposed venture and the pressures placed on hard capital by external forces (competitive compensation and R&D practices, taxes and licenses, inspections, scarcity of inputs, etc.).

*Firm Capital* is a bit-more subtle than hard capital. It consists of the *intellectual*, *social*, *cultural*, and *organizational* capital owned by or available to the enterprise (Desman, 2005). *Intellectual* capital consists of *explicit* (Grant, 1996) and *tacit* (Berman, et al, 2002) knowledge. The former can be accumulated, enhanced, taught, and learned; the latter derives from experience and may not even be subject to conscious recall. The importance of intellectual capital can best be exemplified by its absence: ignorance. *Social* capital (Burt, 1997) is a product of relationship networks that provide contacts (open doors), information, and scripts for constructive social conduct. Malecki (1997) describes *cultural* capital in terms of “know-what and know-why.” It enables one to extract imbedded knowledge from the cultural context that gives it specific meaning. The culture of concern may be the society, industry or organization. *Organization* capital translates to “know-how” and runs the gamut from “who to tell” or “where to find it” to the amassed formal and informal knowledge (e.g. technology, crafts, secrets) in the entire organization (Edvinsson & Malone, 1997).

Firm capital endows the organization with the information necessary to ensure that its objectives are achievable, the knowledge and understanding

necessary to pursue those objectives to successful accomplishment and the access to and support of those outside the organization upon whom success may depend (e.g. preferential treatment or access to valuable or critical information). Again, its sufficiency depends on the nature and scale of the proposed venture and the pressures imposed by external conditions.

Finally, *proprietary rights* may constitute the crucial ingredient for some ventures. Licenses (franchises and permits), contracts (labor and supply), and intellectual property ownership (patents and copyrights) can eliminate a host of entry barriers. Qualifying for set-asides or preferential bidding/supply status may eliminate others (e.g. small or minority owned business). Real property ownership or leases can provide necessary locations or venture-critical natural resources (e.g. timber, ore, range land, water rights). Even national citizenship or participating in extra-domestic joint ventures can open doors that otherwise might be closed. Here, the principal concern is not the sufficiency of the right, although that is important, but its endurance potential. Patents, licenses, and contracts expire; natural resources can be depleted; preferential status may change. Likewise, although the sufficiency of hard and firm capital assets are of primary concern, their sustainability must also be considered.

Whereas the *reality* factors are associated with market demand, the *feasibility* factors relate to market entry and sustainability barriers and the organization's facility to overcome them. Quite simply, extant demand represents insufficient reason to launch a new venture unless the organization has the wherewithal to objectively seize the opportunity and survive whatever pitfalls may arise in the process (cancelled credit lines, technical obsolescence, loss of social or organizational capital due to death or attrition etc.). Given that the intended venture is simultaneously *realistic* and *feasible*; one additional variable must be considered before it can be deemed practicable.

### **Practicable Desirability = f(Entrepreneurial Commitment)**

The quintessential element that sets entrepreneurs apart from "nontrepreneurs" has been the subject of debate ever since the field of entrepreneurship began to diverge from economic theory. The passion embodied in the oft-mentioned *entrepreneurial spirit* has been attributed to psychological characteristics (Brockhaus, 1982), role modeling and job satisfaction (Collins & Moore, 1970), work and educational experiences (Susbauer, 1972), and age (Thorne & Ball, 1981). Although some have questioned the value of such streams of research (Brockhaus, 1982; Van de Ven, 1980) there is something about the borderline-obsession that drives one to "keep an eye on the ball," "shoulder to the wheel," and "nose to the grindstone" that cannot be ignored. Given the occasion of a realistic and feasible opportunity, passion may be just the spark necessary to ignite the new venture flame. At the same time, it may also be the reason some may ignore reality and feasibility and venture forth with great zeal only to be disappointed. Passion is a powerful, albeit often misdirected, human quality not

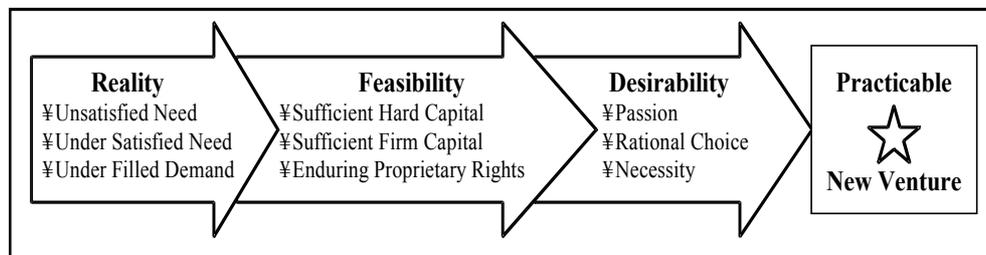
subject to simple explanation.

Lacking the passion to pursue, some might energize the necessary level of commitment and ingenuity as a product of pure rational choice (Vesper, 1990): the opportunity is there for the taking so why not pursue it? The chance to make a profit, achieve independence, or “leave footprints in the sand,” may provide just the necessary impetus to take action. Whereas the passion driven entrepreneur may see the new venture as an end in itself, the more rational entrepreneur is likely to perceive it as a means to some other end.

Finally, it would be naïve to suggest that all launch decisions are products of desire - passion or choice. The newly arrived immigrant, previously unemployed divorcee or widow with dependent children, or downsized executive may have little choice but to pursue any available opportunity. Creating a new venture in such circumstances is a matter of practical necessity; it is the default option. Like the passion driven person, those who pursue a new venture out of necessity are likely to be proactively looking for an opportunity. Like the choice driven individual, the new venture will constitute a means to an end. Their unbridled energy and dedication to success flow from their need for economic survival.

### Discussion and Implications

Although countless tomes have been written on the subject of new venture creation, it appears that nine interdependent variables dictate if a new venture launch is practicable. If reality—market opportunity— aligns with feasibility —the facility to overcome market entry and survival barriers— and they, in turn, align with desirability —the dedication to do what is necessary— the creation of a new venture is indicated and the enterprise has a high likelihood of success. It is a *practicable decision*. Remove the consideration of one variable and the venture is not destined to fail but success becomes highly improbable (there is always luck). In the final analysis certain failure is easier to predict than is certain success. The sequence would follow in the manner depicted in Exhibit 2.



#### Exhibit 2 The Practicable New Venture Sequence

Relative to the data on new venture births and deaths, the idea of *practicability* should be of no small concern to potential new venture founders. This is particularly true for the founders of SMEs as they comprise over 75% of the enterprise failures.

The triads evident in both the structure and content of the sequence model arose as a matter of sheer coincidence. While every effort was made to reflect the body of literature in the construction of the model, it is not without possibility that one or several significant factors were omitted. The reality-feasibility-desirability relationships are robust but are the elements within them complete? To that end, the identification of those factors and strengthening the model might provide fertile ground for further research.

In the process of examining the new venture birth process through the lens of the 3-D decision model, light is shed on a couple of other issues that lie outside the scope of this study but are significant in their own right. Although the stepwise relationship among reality, feasibility, and desirability bear on the practicability of an intended new venture concept, their concurrent states presage extant organization survival or failure. Ensuring that organization goals are simultaneously realistic, feasible, and desirable and then planning, implementing and controlling to support them has both strategic and operational implications. A sound strategy would seem to reflect the 3-D variables.

Finally, the model in Exhibit 2 sheds light on why the definition of entrepreneurship has broadened and how new venture founding became divorced from it in recent research streams. Current contributions appear to focus on parts of the model to the exclusion of the model as a whole. The underlying economic assumptions were modified by subtle definition changes to accommodate these new thrusts: *uncertain* became risky, *personal gain* became benefit, *unprecedented* became novel or creative. Entrepreneurship is, thus, no longer a terminal process that creates new ventures, but an on-going process that spawns new initiatives. The entrepreneur does not surrender to the manager/operator once the fledgling venture can fly. Rather, the manager/operator must remain a perpetual entrepreneur constantly reinventing the organization. Formerly, this was the challenge of strategic management (Hunger & Wheelen, 2007), now it is the role of strategic entrepreneurship (Kuratko, Audretsch & Planck, 2009). Entrepreneurship, once a finite process of creation, gestation, and birth, has become one of infinite navigation, propagation and wealth enhancement.

There is one additional point that seems germane to this discussion. Cole expressed concern that as business became more abstract because of the proliferation of public ownership, professional management, accounting methods, and increased scale and complexity that the classical concepts of entrepreneurship might no longer apply. To that end, he pondered "if there is a term better than 'entrepreneurship' to describe this persisting element in business enterprises" (Cole, 1942, 122). Perhaps the term entrepreneurship has little operational meaning beyond the realm of new venture creation.

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