



# STANFORD

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## GRADUATE SCHOOL OF BUSINESS

CASE: E-323  
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## IDENTIFYING VENTURE OPPORTUNITIES

*I never perfected an invention that I did not think about in terms of the service it might give others... I find out what the world needs, then I proceed to invent.*

—Thomas Edison

### INTRODUCTION

One of the biggest questions on every hopeful entrepreneur's mind is, "how do I come up with a compelling idea for a new venture?" While there is no right or wrong answer to this question, there are several things to be aware of and thinking about as one heads down the entrepreneurial path. Even if a great idea has already come to mind, it is essential to cover the basics – the market, product/service offering, competitive, economic, and team dynamics to determine if the idea has the potential to become a viable venture opportunity.

The objective of this note is to help guide students interested in becoming entrepreneurs. Specifically, this note will cover the common sources of inspiration for finding potential ideas and creating a vision, highlight the importance of capitalizing on trends, and review the basic components of what makes an idea an opportunity worthy of pursuing.

### THE DISCOVERY PHASE – LOOKING FOR INSPIRATION

Where to start looking for an idea? Successful entrepreneurs have found inspiration from many different sources, but often putting an initial stake in the ground is difficult. A good and logical starting point for an entrepreneur is to think about what s/he knows best, especially with regards to work experience; after all, there is great value in learning before doing. According to a recent Inc. 500 study, the "dominant source of venture ideas is prior employment."<sup>1</sup> Work experience is useful because of the relationships and networks one develops and the knowledge and skill-set that is built up around a particular industry/field. Further, the workplace is where the "greatest opportunity for need observation occurs."<sup>2</sup> Since a majority of ideas come out of a former career

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<sup>1</sup> Anne Marie Knott, *Venture Design* (Thousand Oaks: SAGE Publications, Inc.), p. 45.

<sup>2</sup> *Ibid.*, p. 46

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Jocelyn Hornblower prepared this case under the supervision of Lecturer Dr. Dennis Rohan as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

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or consulting work, the entrepreneur should reflect on what s/he learned about industry, products/services, production, marketing, competition, etc. through job experience. There may be tangential opportunities to consider, for example to compete with a more innovative product/service offering or to introduce a novel business model.

Prior work experience is not always required when exploring entrepreneurial ideas. Educational background can be extremely valuable and can provide the entrepreneur with skills and learnings that can be applied creatively, as well as provide the entrepreneur with an established network of students and faculty. Regardless of the area of study, having an educated appreciation for a particular subject matter can be very beneficial in identifying venture opportunities.

Sometimes overlooked sources of inspiration for finding new ideas are travel and personal hobbies. Life experience is just as applicable as work and education in thinking about problems and needs and how best to solve them. Travel, especially international travel, can be an excellent resource as it allows one to take note of what is going on in other parts of the world, to observe trends that are taking root elsewhere but not yet at home, and to experience different ways of doing things. Howard Schultz's inspiration for Starbucks came to him when he was on vacation in Italy and admired the "café culture" there that had not yet taken root in the US.

Another valuable exercise is to reflect on experiences (particularly frustrating ones) as a retail or industrial consumer. Entrepreneurial ideas can be the result of simply being an irritated consumer looking for a better solution, where "in solving their own needs, they often find they satisfy the latent demands of a broader group of users."<sup>3</sup> Recall the origins of Nike – Phil Knight and his track coach Bill Bowerman were dissatisfied with the footwear available for long-distance runners, so they started their own footwear company using Bowerman's waffle maker to produce the rubber soles.

Never underestimate the importance and relevance of contextual knowledge. Many successful entrepreneurs have found their ideas by reading different newspapers and economic and technical publications in order to keep abreast of trends and events taking place around the world. One incredible advantage that students have is the access to resources available at colleges and universities. Investigate what kinds of projects and experiments are going on in university research labs, as students and faculty are often working on cutting edge ideas. Entrepreneurial success stories such as Google, Cisco, Sun Microsystems, and Yahoo all have origins right here at Stanford University. Observe and track recent venture capital investments as guidance into attractive industry sectors and promising trends.<sup>4</sup> VC fundraising topped \$36 billion in 2007, giving those firms the power to handpick the start-ups with the most promising ideas and innovations, and giving budding entrepreneurs the opportunity to compete for much needed growth capital. Attending conferences and trade shows is also an excellent way to learn more about a particular industry and to have the opportunity to interact with experts in the field.

Throughout the idea searching phase, as a general rule of thumb, it is wise to spend time with other entrepreneurs and reach out to innovative thinkers outside of one's personal network. The

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<sup>3</sup> Ibid., p. 47.

<sup>4</sup> Stanford students can access SDC VentureXpert at Jackson Library (GSB) for VC investment information. VentureOne is an additional resource for VC information, available by subscription through VentureSource.

likelihood of discovering ideas and opportunities will increase dramatically by interacting with other creative minds. Try the same ordinary things in new ways and try out new things altogether. Remember to write things down that are frustrating, things that are of particular interest, or random obstacles encountered in life. If something is frustrating, chances are there are others out there who have similar feelings. Observation of customer needs, complaints, and unfulfilled wishes is the first step to discovering potential solutions.

## **TEAM CREATION AND EXECUTION**

“You can have the best business opportunity in the world...but without proper execution, it means nothing.”<sup>5</sup> Although often a significant hurdle, coming up with an idea to pursue is the first of many steps an entrepreneur must take in order to start a new company. Many people think that the key challenge of entrepreneurialism is to validate the concept/idea, but execution and follow-through are far more crucial. Even ordinary ideas executed exceptionally fare much better than brilliant ideas executed poorly. Proper execution is the result of a multitude of factors, one of which starts with forming the right team of people to carry out the idea. Teams are often able to unleash creativity more effectively than an individual, and the right partners or team members can make or break the future success of an idea. Team dynamics also play a very important role when it comes time to present the idea to potential investors and attract high-quality talent.

The skills required to launch a new venture are very rarely all found in a single person. Rather, creating a team of people with diverse and complementary talents, interests, and skill sets, as well as unique perspectives, is necessary to really get an idea off the ground. Successful teams work well together and are responsive and adaptive to the changing needs of the opportunity. Specific talents and skills in leadership, sales and marketing, and technology are important to have within the core team. Leadership is important in order to set the team on the right course and to ensure that everyone is rowing in the same direction. Sales and marketing skills are very useful capabilities for understanding what the need is, who the customers are, and conducting other basic primary research. People with a sales background also tend to be more willing to pick up the phone and make cold calls in order to move an idea forward. If the idea falls within the technology industry, of course it is essential to have a team member who understands in depth the technical aspects of the product/service and the intricacies involved in the technology industry. For example, Bill Joy has been the technical lead in many different entrepreneurial ventures.<sup>6</sup> In this early stage it is not uncommon to suffer from tunnel vision and get bogged down in the details, so above all, it is imperative (for at least one team member) to maintain a sense of objectivity and realism.

Passion and commitment to the idea are essential for successful execution. Being passionate and genuinely believing in the idea produce the necessary motivation and desire that are required for success. Launching a new venture can be a long and often times bumpy road; passion is unwavering and can help entrepreneurs recover from disappointments and discouraging events. Consider the example of Mrs. Fields Cookies. At the age of 20, Debbi Fields was a young housewife with no prior business experience, but with a passion for baking and sharing her

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<sup>5</sup> Joel Hyatt, “Identifying the Idea,” Stanford GSB Video Library, February 1, 2006.

<sup>6</sup> Bill Joy is a co-founder of Sun Microsystems and a partner at VC firm Kleiner Perkins Caufield & Byers.

homemade chocolate chip cookies. She also had perseverance to keep marching forward despite multiple rejections from banks as she sought financing to launch a cookie company. Passion and persistence paid off when she finally got a \$25,000 loan to open the first bakeshop and cookie store in Palo Alto in 1977.

Passion isn't always just about the idea; many successful entrepreneurs feel even more passionately about the company building aspect, creating a culture and work environment and motivating a team of people to achieve a common goal. Regardless, passion facilitates the articulation of the message and business strategy behind an idea, which makes attracting employees and investors a much less daunting task. Passion alone will not guarantee success, so it is important for the entrepreneur to optimize his/her interests and passions for market opportunity. Many people want to become entrepreneurs because they think it is the ticket to personal and financial success. There is no surefire way to success as an entrepreneur. Success depends on so many different factors, and so, ideally, the belief in the idea should trump the desire to make money; success is the upside reward to doing something one believes in.

### THINKING ABOUT OPPORTUNITY SPACE

Understanding the opportunity space around an idea is a critical step in the venture creation process. One of the primary objectives of any entrepreneur should be to find an idea in an attractive and fast growing opportunity space, which requires a thorough understanding of the industry and a willingness to be flexible. The attractiveness of an opportunity space is impacted by external events that relate to macro-level trends and changes, which will be covered in the next section in greater detail.

Thorough industry knowledge is central to understanding opportunity space. An analysis utilizing the Porter's Five Forces framework is one way to discern the relative attractiveness (i.e. potential overall profitability) of a particular industry. The five forces at play are supplier bargaining power, customer bargaining power, the threat of substitute products/services, the threat of existing rivals, and the threat of potential entrants. The entrepreneur should evaluate his/her idea within this framework to get a better sense of the business environment. See **Exhibit 1** in the Appendix for a more detailed overview of the framework.

As the entrepreneur gains a better grasp of opportunity space and industry dynamics, the need for flexibility cannot be emphasized enough. "Things do not always develop as planned and flexibility in business approach...is very important."<sup>7</sup> New data and the discovery of more relevant information require entrepreneurs to be willing to make adjustments to the original concept. "One reason a unique idea is relatively unimportant is that very few ventures succeed with the original idea intact...Rather, firms adapt the original idea to new information."<sup>8</sup> Entrepreneurs may also be in a position that requires flexibility in order to determine a realistic monetization strategy. There have been many great ideas that never turn into actual opportunities because they lack such a strategy, so it is important to understand how value will be realized from the idea, and to be willing to modify the idea or concept in order to have a viable monetization strategy. Entrepreneurs must also be flexible in terms of thinking about a

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<sup>7</sup> Hyatt, Stanford GSB Video Library.

<sup>8</sup> Knott, op. cit., p. 35.

“Plan B.” Even a good idea can lead to early failure if there is limited opportunity space with no alternatives, so be prepared to consider potential product/service extensions and substitutes.

## ENVISION TRENDS AND IDENTIFY EARLY CHANGES FROM WHICH OPPORTUNITIES ARISE

“The overwhelming majority of successful innovations exploit change.”<sup>9</sup> In a rapidly changing world, trends are constantly emerging that profoundly impact business and the way people behave. Entrepreneurial opportunities have a higher likelihood of success if they ride one of these waves of change and are able to capitalize on an anticipated or growing trend early in its lifecycle. Many ventures have been successful because the entrepreneur pursued an opportunity after envisioning a trend, despite minimal evidence supporting the likelihood of its actually taking root. For example, Steve Jobs started Apple in 1976 to sell the Apple 1 personal computer kit. The company’s first major success was the release of the Macintosh computer in 1984, which sold well due to its advanced graphics capabilities and later was credited with creating the desktop publishing market.

Observation and research (reading, talking to experts, etc) are two ways to gain a relevant knowledge base around trends and how business ideas may fare as a result. Trends have the power to significantly impact how people and organizations behave, and an idea will gain traction if it can take advantage of that change in behavior early on in the trend’s lifecycle. As more and more people accept the direction of the trend, momentum will build around it and allow for new opportunities to emerge.

There are four primary categories of changes/trends that influence future business development. Observing change is the first step in determining whether or not an idea can take advantage of a current or anticipated trend. Trends should not be looked at in a vacuum, as an opportunity may capitalize on several trends that converge at once.

### 1. Macroeconomic and Industry Trends

Macroeconomic and industry trends have a significant influence on people, society, economies, and the environment around the world. Macro trends tend to have long lives (can last for decades) and are not easily manipulated. Consolidation and the resulting shifts in industry structure “change the competitive dynamics in an industry and open up or close down niches that may provide opportunities for entrepreneurs.”<sup>10</sup> For example, massive consolidation within the US banking industry has created prime opportunities for de novo banks to emerge as the preferred choice for local banking products and services.

A macroeconomic (and demographic) trend that has gained momentum over the past decade is growth in emerging markets, particularly in China and India. Growth in emerging economies means that there will be more and more consumers with disposable income to spend on discretionary goods and services. As *Figure 1* shows below, household disposable income levels in China (urban mainland) over the past two decades have been steadily rising.

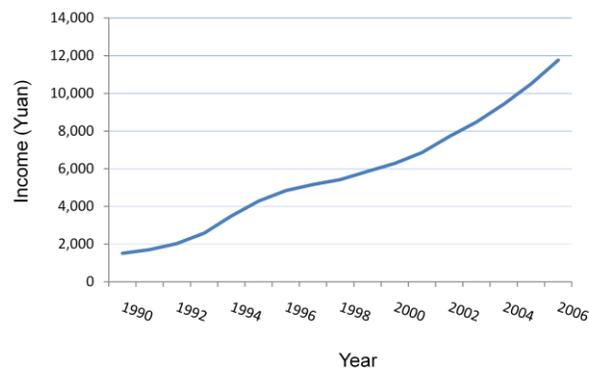
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<sup>9</sup> Peter F. Drucker, *Innovation and Entrepreneurship* (New York: HarperCollins), p. 35.

<sup>10</sup> Scott A. Shane, *Finding Fertile Ground* (Upper Saddle River: Wharton School Publishing), p. 24.

**Figure 1**

Per Capita Annual Disposable Income of Chinese Urban Households



Source: 2007 China Statistical Yearbook, National Bureau of Statistics of China

Chinese auto and battery manufacturer BYD Co. Ltd. is capitalizing on this trend by targeting the growing demand for cars while at the same time being environmentally conscious by offering hybrid and lithium ion battery models. BYD clearly caught this trend at the right time, as validated by Warren Buffet's October 2008 investment to acquire a 10% stake in the company.

## 2. Social and Demographic Trends

Social and demographic trends “open up opportunities for new...businesses by altering people's preferences and creating demand for things where demand had not existed before.”<sup>11</sup> Social trends reflect changes in lifestyles, values, culture, leisure, education, religion, and public health. Demographic trends often are initiated by changes in population groups, life spans, family composition, and disposable incomes. Examples of new ventures launched in anticipation of or as a result of such trends are noted below.

- **Whole Foods Market** was started in Austin, TX by John Mackey in 1980 in anticipation of a growing trend in the US towards health, nutrition and organic foods. This trend has continued to gain momentum ever since, aided also by growing concerns over food safety, namely relating to pesticide use in produce and antibiotic/hormone use in animals. As of early 2008, the company had more than 270 locations throughout the US and United Kingdom.
- **Classic Residence by Hyatt** was founded in 1987 in response to the demographic trend of the rise in the aging population in the US and the resulting need for more retirement communities. Classic Residence by Hyatt promotes “Luxury Senior Living” by catering to affluent senior citizens, and as of mid-2008, had 18 communities throughout the US with more under development.
- **Banco Compartamos**, a for-profit microfinance bank in Mexico, saw potential early on to create a for-profit business opportunity within a traditionally non-profit industry, microfinance. Microfinance, the provision of financial services to the poor, has grown

<sup>11</sup> Ibid., p. 23.

into a global industry since it began in the 1970s, and as this trend became more widespread, Banco Compartamos sought to earn a profit while still “doing good” and subsequently completed a public offering of its shares to the investing public in 2007.

### 3. Technology Changes and Trends

Technological change “allows people to do things that could not be done before or only could be done in a less efficient manner.”<sup>12</sup> For example, many recent IT inventions capitalize on the continued exponential growth in computing power known as Moore’s Law. See **Exhibit 2** in the Appendix for an illustration of Moore’s Law.

These trends are often initiated by innovation, scientific discoveries, and captured through economies of scale, scope and network effects. There are two primary sub-categories of technology trends: applying existing technology to new applications/markets and the discovery of new technology that creates new markets. Several examples below illustrate these types of trends.

#### *3(a). Applying Existing Technology to New Applications and Markets*

With this approach, entrepreneurs come up with ideas to apply technology in new and different ways. There are no major breakthroughs in technology, only slight modifications to existing technology. For opportunities where the internet or software is the key application (such as with eBay, mentioned below), one approach for identifying an opportunity is to rapidly build a prototype for the market, create buzz through blogs and other means, and observe usage, which will guide subsequent modifications.

- Information Technology
  - The technology behind **eBay** created a new industry marketplace for online auction and shopping. Founder Pierre Omidyar wrote the code for the site at his home over a single weekend in 1995 as an experiment of sorts to test how “equal access to information and opportunities affects the efficiency of marketplaces.”<sup>13</sup>
  - **Intuit** was founded in 1983 in order to take the pain out of paper and pencil personal financial accounting. Founder Scott Cook foresaw the growth in the personal computer space and wanted to create a software program that would run on a PC that would be simple and straightforward for customers.
  - **Salesforce.com** was founded by a former Oracle executive who pioneered the concept of delivering enterprise applications over a simple website. By applying existing technology, the Internet and software, in a new way, Salesforce.com successfully created a marketplace for on-demand, web-based CRM (customer relationship management) offerings.

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<sup>12</sup> Ibid., p. 20.

<sup>13</sup> <http://news.ebay.com/history.cfm>

- Medical Technology
  - **Epocrates** provides mobile and online clinical applications for healthcare professionals. By applying technology to assist doctors at the point of care, Epocrates has helped the healthcare industry improve patient care and increase productivity.
- Clean Energy Technology
  - **Tesla Motors** is a technology company that creates high performance, efficient, 100% electric cars by applying battery technology to the traditional auto industry. Tesla has developed a lithium-ion battery pack that is capable of delivering enough power to propel the Tesla Roadster from 0 to 60 miles per hour in about four seconds. Lithium-ion batteries have long been the technology of choice for cell phones, laptops, and other portable applications.
- Financial Theory
  - **Financial Engines**, a web-based investment advisory company founded by Nobel Prize winning economist William Sharpe, uses a computerized program (a sophisticated Monte Carlo simulation) based on Sharpe's contributions to portfolio theory and asset pricing to provide individual investors with relevant retirement planning advice traditionally only available to institutional investors.

### ***3(b). New Technology and New Markets – Brave New World***

With this category, entrepreneurs enable technology to open up new markets. The opportunities that result from this type of vision are not limited to single applications or industries. Rather, companies across a range of industries are impacted by this “brave new world” technology. Passionate entrepreneurs who pursue such revolutionary opportunities have the potential to change the landscape of business and have a significant societal impact.

- Information Technology
  - **Cisco System's** router technology led the way to the commercialization of the internet market in the 1980's. Founded in 1984, Cisco was not the first company to sell a router, but it was the first company to sell commercially successful routers supporting multiple network protocols, which enabled computers of varied make, with different protocols, to communicate and access the early Internet, and permitted data to be exchanged among workstations, mainframe terminals, printers and servers.
  - **Intel** created the first microprocessor in 1971, though it would not become the cornerstone of the company's success until many years later. The company shifted its focus in the early 1980's to dynamic random access memory chips until increased competition decreased the profitability of the market. Intel then shifted its focus back to the microprocessor market, driven also in part by the success of the IBM personal computer. The company soon became the primary and most profitable hardware supplier to the PC industry.

- In 1979, **Oracle** was the first company to commercialize relational database technology, which organizes data into tables that are related to one another. The company's flagship product, Oracle, allowed users to create, analyze and transform data (i.e. employee or customer information) into relevant information.
- Medical Technology
  - Considered the first biotechnology company, **Genentech** was founded in 1976 in order to build a business using recombinant DNA technology to develop products with practical applications.
- Clean Energy Technology
  - **NanoSolar** is a solar power company headquartered in San Jose, CA that has developed and commercialized an extremely low-cost solar cell manufacturing process. The company developed a proprietary semiconductor ink technology that enables the production of solar cells with a basic printing process, which is quick and more efficient than other technologies.

#### 4. Government and Regulatory Changes

Government and regulatory changes generate entrepreneurial opportunities because they alter the market and competitive landscape, impact the demand for and supply of products/services, and open up doors that had previously been closed to business. These types of changes can result from world events, politics, law making, public and economic policy decisions, and regulation/deregulation.

Consider energy and the environment and the regulatory changes implemented in response to global warming. For example, many states have adopted renewable portfolio standards, which are regulated policies requiring increased production of renewable energy sources over a specific time period. These changes and regulations have opened the door to hundreds of alternative energy companies, including solar and wind power start-ups, etc.

An example of past government deregulation that impacted the legal services industry was a Supreme Court decision permitting legal practices to advertise their services. Entrepreneur Joel Hyatt had been fighting for this deregulation because he saw a “public going totally un-served by the legal profession.”<sup>14</sup> The deregulation created an opportunity for Joel to start his own firm, Hyatt Legal Services, which targeted a specific customer segment in order to inform the public about where to go for legal services and how much it would cost them. Before the court's decision, Joel observed that there was no connection between supply and demand of legal services; the deregulation was the prerequisite he needed in order to link the supply and demand.

#### OTHER TYPES OF NEW OPPORTUNITIES

The above four categories of trends create opportunities for entrepreneurs to exploit change in order to introduce new products and services. However, it is also important to think about how these trends can serve as catalysts to thinking about how to provide old products and services

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<sup>14</sup> Joel Hyatt, Stanford GSB Video Library.

that already exist in new and innovative ways. For example, an entrepreneur may discover an idea to pursue that involves a more efficient way of organizing, uses different raw materials, and employs an improved production process.

### 1. Developing Specialized Technology

A fairly common strategy for technology entrepreneurs, particularly in the biotechnology and IT industries, is the “create to merge” approach. This approach is pursued by entrepreneurs who have a firm grasp of an industry and its structure and have identified a hole in a product line. A company is then built around that hole in order to prove out the technology and market, with the intent of selling it to one of the larger, established players in the industry with large sales and marketing organizations. In short, it is akin to providing outsourced research and development. For example, both Cisco and Johnson & Johnson have obtained important capabilities through this type of acquisition.

### 2. Novel Business Models

Entrepreneurs with novel business models come up with new ways of providing products and services; establish new standards and norms; and redefine how companies can operate within established industries.

- **Costco** successfully redefined the low price, high volume sales model by eliminating traditional costs such as salespeople, delivery, billing, and accounts receivable. As a result of dramatically reduced overhead expenses, Costco passes these savings onto its customers.
- **Dell** became a strong competitor in the computer industry by introducing a new distribution model – selling its products directly to consumers, thereby bypassing the traditional middleman. As a result, Dell is able to interact directly with its customers and gain valuable insights, as well as pass on cost savings.
- **Grameen Bank (GB)** is an example of a non-profit business pursuing a novel business model. GB reversed conventional banking practices by removing the need for collateral in order to qualify for a loan, creating a banking system that extends credit to the neediest people. As of August, 2008, it had 7.6 million borrowers, 97% of whom are women. With 2,529 branches, GB provides services in 82,994 villages, covering more than 99% of the total villages in Bangladesh.<sup>15</sup>

### 3. Follow the Leader

This approach refers to the pursuit of an incremental opportunity by imitating what another company is doing with some modifications. This approach is worthy if an entrepreneur can build a product or offer a service in a “faster, better, and cheaper” way.

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<sup>15</sup> [www.grameen-info.org](http://www.grameen-info.org)

- **E\*Trade Financial** achieved success as the first online brokerage firm. The internet enabled E\*Trade to gain ground in an already mature market, since established brokerage firms did not move as quickly to the online model.

#### 4. Combination

Entrepreneurial ventures are also often the result of a combination of different forces.

- Applying new technology and a novel business model, **Google** pioneered the search engine and internet advertising industries in order to improve how the world's information is organized. Founders Larry Page and Sergey Brin developed a mathematical algorithm (PageRank) to produce better and more relevant search results. Google's keyword advertising services changed the way that companies think about internet advertising.

#### CHARACTERISTICS OF A VIABLE IDEA – WHAT MAKES AN IDEA AN OPPORTUNITY?

“Ideas interact with real-world conditions and entrepreneurial creativity at a point in time. The product of this interaction is an opportunity around which a new venture can be created.”<sup>16</sup> No matter how unique or amazing an idea may seem, before moving ahead with a full-fledged business plan and conducting extensive market research, it is useful to assess the basic viability of an idea and to understand the characteristics of viability. After all, a good idea is not enough, there needs to be a good opportunity that “has the qualities of being attractive, durable, and timely and is anchored in a product or service, which creates or adds value for its buyer or end user.”<sup>17</sup>

#### The Customer, the Product, and Competition

A viable idea addresses a specific unmet customer need or problem. In addition to having a basic understanding of who the target customer is, it is critical that the entrepreneur can articulate what the value proposition is to the customer. A compelling value proposition is based on real value, as opposed to perceived value, and is differentiated and sustainable. Ideas that are “nice to have” are simply ideas, whereas an idea that is a “compelling must” is an opportunity. Go after “big” problems – a “big” problem to be solved yields an attractive opportunity space.

Consider the competitive landscape – how does the idea stand out from the competition? If entering an established market with close competition, the idea must be differentiated and offer a unique value proposition that sets it apart. “To be successful, you need to start your new business in response to an opportunity to create a new product or service that meets customer's needs that have not been satisfied adequately or that satisfies customer needs in a much better way than established companies satisfy them.”<sup>18</sup> If there are entrenched competitors, then it is important to understand the switching costs customers will face.

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<sup>16</sup> Jeffrey A. Timmons, *New Venture Creation* (New York: McGraw Hill), p. 82.

<sup>17</sup> *Ibid.*, p. 82.

<sup>18</sup> Shane, *op. cit.*, p. 19.

## The Industry and Marketplace

The industry an entrepreneur chooses is closely linked to viability and can be a significant determinant of the success or failure of a venture opportunity. For example, many successful ventures have been created out of the software, medical device and internet industries. As discussed earlier in this note in the section on opportunity space, having an in-depth understanding of the industry and marketplace is a necessity.

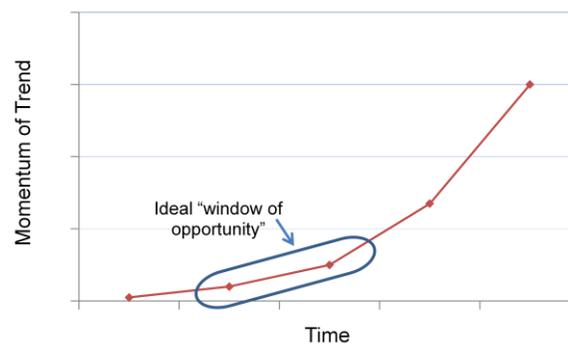
As a general rule, chances for success are much greater in large and growing markets that are favorable to the entrance of new firms and start-ups and that will attract new (not just existing) customers. Entrepreneurs should also seek out opportunities in markets that s/he envisions will be large and growing at the time of launching the venture. If there is already an existing marketplace, ideally there is a situation where actual and latent demand exceeds supply, which leaves room for new players to compete. Finally, there should be clear potential to capture significant share of the marketplace.

At this stage, it is useful to form hypotheses about industry and marketplace characteristics highlighted below that will impact the viability of an idea. These hypotheses will be tested in much greater detail in the business plan and market research phase, but in the meantime, seek answers to questions by talking to industry experts and conducting interviews with potential customers, suppliers, and competitors.

- Overall market structure: the ideal marketplaces that are most amenable to the entrance of new firms tend to be large and growing, emerging or early on in their lifecycles, and fragmented and imperfect.
- Capital intensity of the business and complexity of the production process: businesses that are very capital intensive require large amounts of start-up capital (i.e. money to buy equipment, supplies, etc) or capital to exploit the opportunity at commercial scale. If launching a new venture that is capital intensive, the entrepreneur will most likely have to seek capital from investors, whereas an early stage start-up with low capital needs is more likely to be bootstrapped or funded by friends and family.
- Other expenses to consider: in terms of research and development, how much new knowledge creation is required to generate products and services? What is the relative advertising intensity of the industry and how will that translate to sales and marketing expenses for the start-up?

## The Timing

Most good ideas are subject to a specific window of opportunity when the timing is just right to launch a new venture, especially one that takes advantage of a current or anticipated trend. Trends can last for decades, but the window of opportunity to ride a trend is comparatively quite short. *Figure 3* below illustrates the notion of timing. Once the window opens, seize the opportunity, do not just sit by idly studying the landscape.

**Figure 3**

### The Risk and Reward Framework

As an entrepreneur, think like an investor. After all, the entrepreneur is the largest investor in the venture, committing his/her time, passion, and career. Entrepreneurs must be vigilant and constantly searching for ways to mitigate the major risks in the venture, which broadly relate to the market opportunity, product/service offering, and management team. Search for opportunities where the primary risk is only in one of these categories.

To illustrate this principle, think about two examples. First, consider the idea of starting a company with a proven team of outstanding scientists and managers, focused on developing a potential proprietary drug that shows early promise as a cure for stomach cancer. With a large market and a solid management team, here the only major risk is technical – can the drug be developed? Consider another example of creating a chain of healthy fast food restaurants across the US with an unproven management team. Here the challenges are more widespread, including market and competitive risk, product/service offering risk, and risk whether or not the management team can execute.

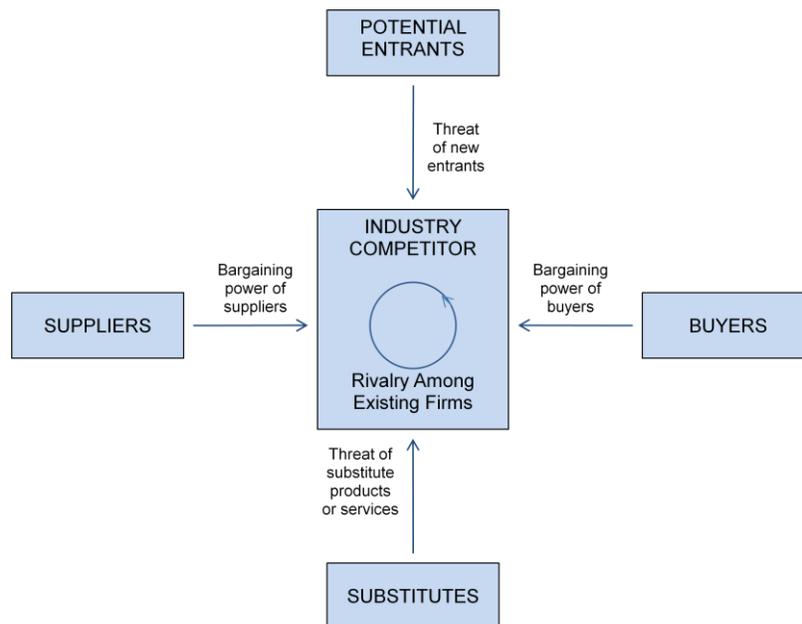
Experienced and successful entrepreneurs and investors have taught us that the greatest risks are usually in the market/competitive arena, followed by management team risk. Examine these risks carefully. Clear preference is for opportunities with large potential rewards and with major risk in only one area, coupled with a plan towards its early mitigation. Of course, entrepreneurs often pursue complex opportunities with several dimensions of risk, and this approach can prove successful if the venture is in a large and growing market.

### SUMMARY

In conclusion, this note should serve as a guide for entrepreneurs pondering the question of how to identify venture opportunities. There are endless sources of ideas out there, but one's chances of success are greatly improved if the idea solves a big problem in a potentially large and growing market, offers a compelling value proposition, and capitalizes on an early trend. Specifically, macroeconomic, social, demographic and technology trends create significant opportunities for entrepreneurs, as do government and regulatory changes and technology innovations. Timing is critical and entrepreneurs must take advantage of open windows of opportunity. Success depends on a number of factors, most importantly the overall attractiveness of the opportunity space and the ability of the management team to execute. The team must

possess the necessary skills and be able to present the idea in a compelling way, since investors place enormous value on the quality and commitment of the core team. Finally, never underestimate the importance of passion, perhaps the most powerful motivator for successful entrepreneurs.

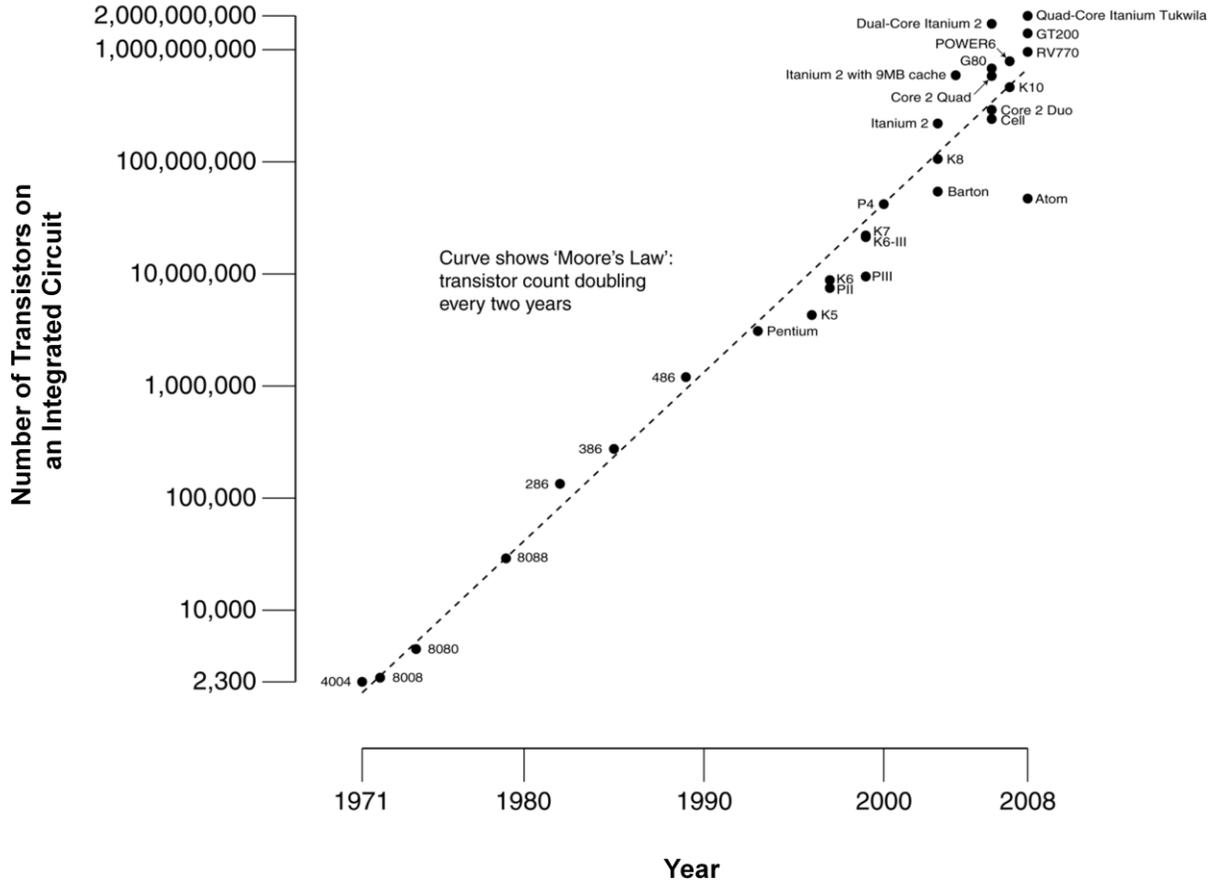
### Exhibit 1 Porter's Five Forces



Source: Garth Saloner, *Strategic Management* (New York: John Wiley & Sons), p. 126.

- **Suppliers**
  - Who will be your company's potential suppliers and how powerful are they (i.e. business partners, suppliers of capital, employees, etc.)?
  - Are there good substitute inputs?
  - What are the costs of the inputs relative to the economics of the business?
- **Customers**
  - Who will your company's customers be and how price sensitive are they?
  - How are they segmented and how powerful are they?
  - What is the buyer concentration to firm concentration ratio?
- **Competition**
  - Who are and will your company's key competitors be?
  - What are their value propositions?
  - How diverse are the competitors? Are there economies of scale, scope or network effects?
- **Barriers to entry**
  - What prevents other firms from entering market and competing?
  - What is the degree of threat from other new entrants?
- **Substitution**
  - What are the substitutes for the products/services that your company provides?
  - How easily can customers do without your company's products/services?
  - What are the switching costs to the buyer?

### Exhibit 2 Moore's Law



Source: www.wikipedia.org