"Identifying the Entrepreneur’s Goal for the Business" from The Entrepreneur’s Intellectual Property & Business Handbook

Jon M. Garon
Identifying the Entrepreneur’s Goal for the Business

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This article is part of a series of book excerpts from The Entrepreneur’s Intellectual Property & Business Handbook, which provides the business, strategy, and legal reference guide for start-ups and small businesses.

An important decision to the development of a start-up business is the purpose for launching that business in the life of the entrepreneur. The purpose will, in turn, strongly influence decisions about where to raise money to start the venture and how to organize the ownership. This short exploration of the psychology behind the entrepreneur’s motivation should help predict which decisions will most likely help the business goals.


Given the risk inherent in running one’s own business, most people choose the safer road of employment. Successful entrepreneurs should have a good understanding of the motivation which encourages them to launch their ventures.

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Some of the more common reasons include the following:

- Freedom from having a boss.
- Keeping the financial rewards for me rather than letting them go to my employer.
- Allowing myself to accomplish my professional goals in a manner that is not available as an employee.
- Building a family business to hand down to future generations.
- Making what I know work for me.
- Choosing the only way to make money and meet my family or other obligations.
- Owning my own business creates the best social and professional opportunities I can achieve.
- Believing in the value of my ideas and inventions.
- Finding no company who could do what I planned to do.
- Achieving my goals that have nothing to do with money.
- Making money from my hobby, passion, or vocation.

None of these reasons is better than the others, but they do suggest different goals for different entrepreneurs. As a result, the planning choices may vary depending on which reasons dominate the decision to forego the safety net of employment and jump into the shark infested start-up waters. A few examples of these reasons will help illustrate the choices.

Emilio is a first-generation U.S. immigrant. Coming to the United States from Mexico City to find work, Emilio started as a busboy and worked his way up to managing restaurants. Restaurants, however, are high-risk businesses that require a great degree of capital. Instead, to launch his own business and gain financial independence, Emilio began as a caterer, working weddings, corporate events, and other social occasions. With only the smallest of family loans, Emilio slowly expanded the number of ovens, trucks, and employees required by his business. Eventually, his specialties grew so popular that he opened two retail locations and sold his specialty products through restaurants in other locations as well. At each stage in the company’s growth, Emilio ignored offers to sell his company to wholesale food distributors or to merge with larger catering companies. Instead, the mix of catering, retail, and specialty foods gave Emilio the ability to build the business, create a large work force—primarily of similarly situated immigrants—and to provide a strong economic and political presence in his community. For an entrepreneur like Emilio, the goals of creating a sustainable business that he can give to his family and improving his community are the primary motivations for the business.

Gwen is a creative artist. She is an excellent amateur photographer, designs her own clothes, and has worked as the financial analyst or comptroller for various studios and galleries. When Gwen launched her own fashion store, it was because she could not promote her own work through any other outlet. Over time, she found that her photographs and her jewelry sold better than her clothing designs. The jewelry sold internationally through her Internet website, Etsy, Amazon, and eBay. The photographs began appearing on consignment in other galleries and restaurants. Within three years,

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1 Based loosely on Manny Gonzalez, owner of Manny’s Tortas, which is perhaps Minnesota’s best Mexican restaurant.
Gwen’s fashion design business was a “failure” not because she did not sell any designs, but because the success of her jewelry and photographs left her too little time. Gwen was motivated to open her own business because she could not develop distribution for her work without selling it herself. By owning her own retail shop, she also learned what worked best and adjusted her business to maximize her interest and opportunities. The investors did not mind that the goods changed, so long as the revenue continued growing.

Addi patented a new board game. After realizing that the large toy companies interested in the game would pay the equivalent of $1.00 per game sold, Addi realized that a great deal more money would be made producing and selling the game herself. Addi was a retired locomotive engineer, so the time spent marketing her game also provided her the chance to be productive in retirement.

Karen worked for an automotive shop, detailing cars and motorcycles. She had developed a method that utilized specialty paints and dyes to apply a unique finish to the vehicles she prepared. Her employer was a franchised car detailing company which did not approve of her method. After encouraging her to meet with the owners in the corporate headquarters, her boss told Karen that she could no longer use her method because the headquarters had not approved its use. Karen opened a detail shop across the street from her former employer and also patented her unique process, which she was then able to license to other detail shops across the country.

Lee wrote a software program designed to improve the speed and reliability of banking transactions conducted on home computers. The software allows banks to reduce fraud and speed up the transactions for their customers. Lee hopes to acquire enough money to test the software, finalize the product, and sell it to one of the larger U.S. or international banks so that he can retire.

Emilio, Gwen, Addi, Karen and Lee reflect some of the common stories told by entrepreneurs. The stories illustrate the range of entrepreneur goals and highlight how these goals will affect the relationship between the entrepreneur and others engaged in forming the business.

2. Lifestyle Business to IPO.

In business circles, the most notorious tension in business psychology is the dichotomy between the lifestyle business and the business seeking to cash out through an initial public offering (IPO). The lifestyle business is a company built to be owned throughout the professional life of the entrepreneur. In the examples above, Emilio and Gwen are operating on the lifestyle end of the continuum. Emilio’s decision not to sell his specialty brands to food wholesalers is a refusal to consign the company to others, even if the financial offer is generous. In addition, the structure of Emilio’s business that combines retail restaurants, wholesale and retail catering, and wholesale product sales to other restaurants improves the company’s income but makes the sale of the company to any third party more difficult. Combining these three income streams reduces the kinds of companies that could benefit from a merger.

Companies that hope to be purchased or merge with other companies tend to be highly focused. A tight business focus allows potential buyers to more readily value the company and determine precisely how the target company can be integrated by the acquiring company. Without this tight focus, potential buyers will not be able to easily value and integrate the potential acquisition.

Gwen’s company is also a lifestyle company. Balancing clothing design, photography, and jewelry is an extension of her personality. Except for Gwen’s creativity, these fields had little in common. Nor did any of the three fields have enough to support a sale or merger. Gwen could potentially license her photographs to an art distributor or gallery management company, but that would create a new representative for the sale of her work, not a buy-out option.
In contrast to Emilio and Gwen, Lee is explicitly building his company for purposes of the IPO or sale. Whether the company becomes publicly traded because of the size of its software sales or is sold for a large amount of cash or stock from a national bank, the result is a change of control and a large, typically one-time payout for Lee.

The examples of Karen and Addi are examples that fall in the middle of the continuum between a lifestyle business and an IPO play. Both are willing to operate their businesses as long as needed and both seem to enjoy the success of their companies. But neither is primarily motivated by the independence of operating the business. Instead they are motivated by the inability to achieve their goals in other ways. For the right financial reward, it is likely that both would sell their companies or sell stock in the companies and allow professional management to step in.

The decision to launch a lifestyle business is no better or worse than the decision to launch a company that is designed to be acquired. The entrepreneur, however, must understand this decision in seeking and structuring investments so that the investor’s goals and the entrepreneur’s goals align properly. Since the investors have a clear understanding regarding their investments, it is the entrepreneur who must plan carefully.

3. **The Psychology of Venture Capital.**

In contrast to the psychology of entrepreneurs, the psychology of the venture capitalist is very simple and clear. A venture capital fund is a company that has accumulated a large amount of money to invest in a start-up company early in its business cycle. The early investment generally means that the investor runs a significant risk that the company will fail, and the investment will be lost. As a result, the potential reward for the investment must be many times the size of that initial investment.

For example, if only one in five businesses is successful, then the venture fund which funds the successful companies should expect at least a five-fold return on its investment just to break even. And the venture fund does not merely hope to break even—it hopes to provide a substantial profit to its investors.

The second aspect of the venture fund’s expectations is the amount of time the venture fund is willing to wait for the return. Generally, venture funds want to recoup the investment and the profit in a period from eighteen to thirty-six months. The question for the venture fund is which of its opportunities will generate the greatest annual return. For example, an investment that creates a ten-fold profit in one year would need to create a thirty-fold profit in three years for it to maintain the same annual return.

In his book, *The Startup Garden*, Tom Ehrenfeld explains the importance of understanding the psychology and motivation of the investors. “[M]ake sure that you find investors whose interests align with yours. … And be clear with others what your long-term goals are. You don’t want to surprise investors if you eschew rapid growth, or make other decisions that are consistent with your vision, yet don’t reconcile with theirs.”

The capital fund manager wants to know the potential upside of the investment and the timeframe in which that investment will be realized. For entrepreneurs that have the potential for large returns on investment in a short period of time, venture capital may be the best way to fund their companies. For entrepreneurs that expect a longer-term return on the investment, other types of funding may be more appropriate.

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Applying Funding Goals to Lifestyle Needs.

The relationship between financing and lifestyle is very straightforward. The longer the entrepreneur desires to own the business, the more the entrepreneur should prefer debt to equity and partners to venture capitalists.

From the examples above, Lee should seek venture capital funding because it will provide the funding necessary to launch the company quickly and will also provide connections for presenting the software to multinational banks or for launching the company into the public markets. Emilio, in contrast, should seek small SBA-guaranteed loans or lines of credit as he slowly expands his business. A restaurant owner or chef embodies the brand of most non-chain restaurants. The reputation, and therefore the trademark of the restaurant, is based on that “know-how.” If the restaurant expands beyond the personal supervision of that individual, it risks losing its uniqueness, and because the restaurant business is extremely competitive, it risks losing its market edge. For restaurants, protection of reputation is more important than the speed of growth, so lines of credit allow Emilio to control the cost of debt while expanding only as needed.

Lee and Emilio reflect the extremes of entrepreneurship. Karen illustrates its center point. Her patented paint process has an immediate impact on the automotive industry and may have potential in other industries. Her decision to open a retail detail shop—across the street from her former employer—suggests both a lifestyle choice and an attempt to capture some of her former business’s goodwill for her new venture.

A venture capital fund would be likely to care more about the paint technology and seek to own that rather than the individual shop. If the technology proves successful, it could launch a national chain of body paint shops, either through direct ownership or by franchising the business to individual store owners. By understanding the choices created through the business model, Karen can maximize her opportunities and put the investor’s funds into the best activities.

Addi, the game designer, is similarly in the middle of the financing continuum. She can grow the company slowly as she sells the game to retailers and directly through the Internet. It may grow, but it is likely to take a great deal of time. She can sell to a large company, but her experience suggests that this will earn her the least amount of money, and she will lose control over her game.

Addi can seek loans or investment dollars to increase the marketing efforts of the game. Addi would also do well by growing the market for the game through crowdfunding. With investors, she could also decide to grow by creating other games and building a new game company with a line of products. Such a business would be unlikely to attract venture capital since the business growth would still be slow, but it could attract private investors to help her launch this effort.

To illustrate the relationship, a graph would show that the shorter the intended ownership, the more likely venture capital is appropriate and the longer the intended ownership, the more appropriate is debt financing.
The chart represents a simple summary of the goals of the entrepreneur and financier. Balancing the needs of the entrepreneur with the goals of the investor or lender is a necessary first step in aligning these interests and reducing conflict. A venture capital fund may seek an exit strategy of one to three years, while other investors may be more committed. Still, investors will want some liquidity and the ability to sell their interest far sooner than lenders, which may provide loans that last up to twenty or more years. As a result, the entrepreneur should align his goals with the financier by selecting the right type of financing for the company.
5. **Scale and Profitability for the Investment.**

The second relationship of importance to the financier is the scale of profitability. The potential for profitability comes from the relationship between relevance and market size \( \text{Profitability} = \text{relevance} \times \text{market size} \). The larger the market size for the product or service, the greater the potential profitability there is for the entrepreneur and investors. Lenders, of course, merely receive a return of the principal and interest, so lenders do not participate in the success potential of the enterprise.

A product that can be used by every person in the United States has more potential than a product that can be used only by children in Des Moines, Iowa. Size does matter. Food, entertainment products, and certain medicines fall into the category of potential relevance with every person in the United States. An aviation sensor has a much more limited market.

Relevance reflects the value placed upon that item by the market. One potential measure for relevance is the share of the market controlled by the seller of the product or service. Microsoft Windows computer operating software once controlled over 95% of the U.S. operating software market, making it highly relevant. Although it has lost ground to Apple, it still retains over 82% of the market. Apple, which failed to compete in that field, was successful in securing greater than a 75% market share with its iPod product (and holding a 95% market share in the first two years of its launch in 2001). In both cases, alternative products exist, but copyright and trademark keeps the competition far behind.

Price also affects profitability. Ten percent of $1.00 is a lot less than 10% of $1,000,000. An aviation sensor may be worth more than many inventions if it is worth enough for each airline to install it. Microsoft has priced Windows in such a way that it is very cost effective for computer manufacturers to include it with the computer, something that its early competitors failed to understand until it was too late.

In the first edition of the book, it was noted that Apple’s iPod will have a much harder time maintaining its market share than Microsoft’s Windows because competitors can use price and features to challenge iPod’s relevance. This proved to be the case. Nearly two decades after the launch of the iPod, Apple continues to be the largest seller of tablets despite a dramatically more competitive marketplace. Today the iPad has roughly 25% of the market, while Amazon increased its market share to over 15% and Samsung has the third position with 14%.

The copyrighted software used by Apple gives it exclusive rights, but other software authors created their own media systems. The iTunes dominance in music did not translate to control over video, books, and newspaper distribution. Copyright provides modest exclusivity, but not the powerful monopoly of patents. By creating similar features at a lower price, Amazon has emerged as a much more powerful competitor. By managing price points, Samsung has reshaped the economic stratification of the market.

For start-up businesses relying on exclusivity, the relationship between market size, relevance, and price will inform the investor of the potential profit that an investment can bring. Early on, these projections are necessarily speculative; however, they do provide at least a benchmark for pricing the investment.

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**EXAMPLE—Jewel’s Jewelry**

Lana Jewel has worked for ten years in the fashion industry and has developed a strong reputation for her original jewelry. Some of her work has been featured in exclusive collections as well as in films.
She plans to launch a collection. Each design will be protected by copyright, trademark and publicity rights in Lana Jewel’s name.

<table>
<thead>
<tr>
<th>Business Plan Preparation</th>
<th>Mass Consumer</th>
<th>Department Store</th>
<th>Designer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market Size</td>
<td>Very Large</td>
<td>Mid-size</td>
<td>Small</td>
</tr>
<tr>
<td>Relevance</td>
<td>Small—designer name not highly known</td>
<td>Medium—some recognition of designers</td>
<td>Large—designer well known in elite circles</td>
</tr>
<tr>
<td>Price</td>
<td>Lower priced goods create alternatives</td>
<td>Medium priced goods create alternatives</td>
<td>High priced goods create alternatives; exclusive pricing a plus</td>
</tr>
<tr>
<td>Material (affects price)</td>
<td>Glass, plastic and silver plate to reduce price</td>
<td>Mixed media of semi-precious materials; gold plate and silver</td>
<td>Semi-precious and precious stones; gold, silver, and platinum</td>
</tr>
<tr>
<td>Anticipated mark-up</td>
<td>25-50% markup</td>
<td>50-100% markup</td>
<td>100-500% markup</td>
</tr>
<tr>
<td>Profitability</td>
<td>Large market with small profit per item; most like a commodity</td>
<td>Good-sized market with reasonable profit on items</td>
<td>Small, exclusive market with excellent return on investment</td>
</tr>
<tr>
<td>Strategy</td>
<td>Avoid this market or cycle into it with previous designs</td>
<td>Good market for items less popular in exclusive shops or recycled from prior year’s designs</td>
<td>Primary market for goods. Build reputation and trademark, which can be extended into department store</td>
</tr>
<tr>
<td>Business Plan</td>
<td>Do not participate in this market</td>
<td>Create simplified trademark to show association with exclusive shops, but distinct from those shops</td>
<td>Invest in trademarks, copyrights and publicity rights of name</td>
</tr>
</tbody>
</table>

As demonstrated from this table, a comparison of the potential for Jewel’s jewelry provides a logical business strategy. The greatest profitability flows from the exclusive shops. This maximizes relevance through Lana’s prior activities, highest profit per item and highest percentage return on the goods. Through copyrighted original designs and the development of both a trademark in the jewelry line, along with the publicity rights associated in Lana’s name, relevance and exclusivity can be established. These can then be extended into the larger, but somewhat less profitable sector in the department store trade.

A second trademark will be created exclusively for those goods sold through department store channels (and perhaps different versions of the trademark for different department stores). In this way, the department store sales will not siphon exclusivity built through the designer shops. The copyrighted designs can be “recycled,” meaning that the new designs for the designer shops can be used in the department store in the following seasons. In this way, the designer shops always receive the newest of the original designs. Combined with the most expensive materials, the designer shops will not be directly affected by the department stores, and the two markets can both be maintained.
The decisions involving lifestyle objectives and financing goals combine with decisions regarding pricing and primary markets to develop the key features of the business plan. As with the example above, the answer to these questions help outline the business plan for the company.