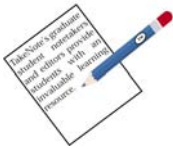


These notes represent a detailed interpretation of the professor's lecture. They are not a transcript of the lecture. TakeNote® is best used as a supplement to your own notes, not as a substitute.

Lecture Date: Tuesday, September 11, 2007

Announcements:

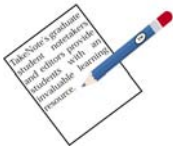
- A representative from Proctor and Gamble came to talk to the class about recruitment for full time and internship opportunities.
 - The second quiz will take place next Thursday and will cover chapters 3, 4, 9, and 10. The material in chapter 4 between pages 115-123 will not be covered in class, but is fair game for the quiz.
- I. Today, we are going to skip from chapter 3 to chapter 10, which covers business strategy.
- A. Why is a strategy important?
1. Entrepreneurs must be stronger than their competitors in order to stay in business and survive.
 2. The typical entrepreneurial effort lasts less than three years, never generates a profit, and is either abandoned or ends in bankruptcy.
- B. Today we will approach the question, “What differentiates the businesses that succeed from those that fail?”
1. The two fundamental things missing from a failed business are good marketing and resources.
 2. In addition, **uniqueness** sets apart successful startups from failures.
 - a) Examples of uniqueness include a new service model, location, etc.
- II. The concept of uniqueness correlates to the topic of **competitive advantage**.
- A. There are two established definitions for competitive advantage:
1. A firm is said to have a sustained competitive advantage when it is implementing a value creating strategy not simultaneously being implemented by any current or potential competitors and when these other firms are unable to duplicate the benefits of this strategy (Barney, 1991).
 2. An enterprise has a competitive advantage if it is able to create more economic value than the marginal (breakeven) competitor in its product market. The economic value created by an enterprise in the course of providing a good or service is the difference between the perceived benefits gained by the purchasers of the good and the economic cost to the enterprise (Peteraf and Barney, 2003).
 - a) There are two key elements to this definition of competitive advantage.
 - (1) The business must at a minimum be able to compete with the least competitive opponent in the market.
 - (2) In addition, an entrepreneur must recognize that there is a difference between what a product costs him to make and what the product's perceived value is to customers.



- B. Competitive advantage precludes others from imitating the business perfectly.
 - 1. Is Krispy Kreme imitable?
 - a) Yes. By and large the concept of having fresh doughnuts is imitable; however, is more difficult to produce fresh doughnuts on location rather than elsewhere.
- C. Competitive advantage allows the entrepreneur to capture profits from exploiting the opportunity.

III. We are going to listen to video-clips of **Mark Brandt** of **Notiva**, now **Maple Fund**, **Mark Practico** of **avatartechnology.com**, and **David McElroy** of **Verdia** in order to gain insight into what a competitive advantage means.

- A. The professor plays a video-clip of **Mark Brandt's** interview.
 - 1. Competitive advantage is everything in a successful venture.
 - 2. Although patents and copyrights are important to sustaining a competitive advantage, even more important is the need to repeatedly prove your capability to leaders of the industry.
 - a) It is important to do this quickly, however, not at lightning speed.
- B. What does competitive advantage look like to Brandt?
 - 1. Brandt looks at competitive advantage in terms of a learning curve.
 - 2. As long as Brandt is further along the curve than his competitors, he is able to do something that nobody else can do, regardless of his/her resources.
- C. The professor plays a video-clip of **Mark Practico's** interview.
 - 1. Each business is constantly trying to answer the question, "What is the next thing that will make me better than my competitor?"
 - 2. For avartechnology.com, good customer service has always served to separate them from the competition.
- D. What does competitive advantage mean to Practico?
 - 1. Practico relies on excellent customer service, which is made possible by his business's small size and competent team of employees, in order to sustain a competitive advantage.
 - 2. Superior technology forms the underlay of the business but more important is first-rate customer service.
- E. Finally, the professor plays the video-clip of **David McElroy**.
 - 1. Technology that others do not have access to is an important part of competitive advantage. Furthermore, this allows the company to genuinely help its customers, who by purchasing the technology gain a competitive edge over their competitors.
 - 2. Because the business is small, it is looking for a larger partner in order to allow for a broader application of the technology.
- F. How does competitive advantage look to McElroy?
 - 1. A startup is in a slight predicament in that it may have a great competitive advantage, but it is too small to possess the necessary capital to appropriate its full value. Therefore, McElroy is looking for alliances.

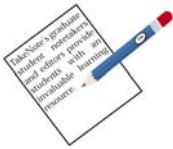


IV. What does a competitive advantage feel like to an entrepreneur?

- A. First, it feels like a time-advantage.
 - 1. Brandt talked about the importance of being ahead of the learning curve in order to gain a competitive edge.
- B. Second, competitive advantage feels like a technology advantage.
 - 1. Part of competitive advantage can mean having control over a process or machine that is superior to anybody else's.
- C. Third, part of a startup's competitive advantage often involves smallness.
 - 1. There are both costs and benefits of smallness.
 - a) One negative aspect of smallness is that it can restrict your ability to appropriate the full value of your competitive advantage.
 - b) What are some of benefits of smallness?
 - (1) A positive aspect of smallness is that enables your business to fly under the radar of larger competitors, who have the ability to push you out of the market.
 - (2) Furthermore, it mitigates some of the enormous risk in an entrepreneurial venture.
 - (3) Finally, smallness can help you better serve your customers. In the case of Practico, his company's size was essential in providing personalized customer service.

V. It is important to establish **barriers to competition** to maintain competitive advantage.

- A. The first component is that it is important to maintain **secrecy**.
 - 1. The concept of **arrow's paradox** revolves around secrecy. It says that on one hand it is necessary to explain the idea in order to gain new backers, customers, and support. However, on the other hand, by talking about the idea too much, others can steal it from you.
 - a) One way to get around this is to have others sign a confidentiality agreement. This can only take you so far, however. If your idea is absolutely amazing, then someone may be willing to pay for the costs of breaking the agreement in exchange for your idea.
- B. The second component is to establish **barriers to imitation**.
 - 1. The first way to do this is through controlling resources.
 - a) An example of a company that does this is deBeers, who owns all of the diamond mines in order to preclude competition.
 - 2. Second, an option is to establish legal barriers to imitation.
 - a) An example of a legal barrier to imitation is a copyright or patent.
 - 3. Third, you can establish a reputation.
 - a) Krispy Kreme is a company with a very positive reputation.
 - 4. Fourth, innovation can serve as a barrier to imitation.
 - a) Constant innovation leads to the ability to maintain a time-advantage.



5. Finally, a last way to create barriers to imitation is through exploiting the idea on a large scale.
 - a) Although there are advantages to smallness, being large allows you to push other competitors out of the market.

VI. We are now going to examine secrecy in greater detail.

A. A **trade secret** is a piece of intellectual property regarding a process or product that is unique to your business.

1. If you believe that your company has a trade secret you must go to court, where a judge will make the ultimate determination.
2. An example of a trade secret is the Coca-Cola formula.
 - a) Courts have upheld the fact that this formula constitutes a trade secret and therefore deserves protection.

B. **Causal ambiguity** involves knowing how to exploit an opportunity through a combination of elements.

1. Can you think of any product where this might apply?
 - a) Disney overall creates a phenomenal experience that is extremely difficult to replicate. Some of the elements that contribute to the experience include cleanliness, variety, imagination, etc.
 - (1) It is impossible to identify the one factor critical to its success. Instead, all of these factors coalesce to make the Disney experience special.

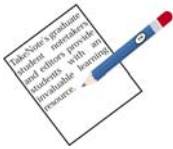
C. **Tacit knowledge** is knowledge that isn't codified.

1. Adobe is a great example of a company that uses tacit knowledge. It is difficult to replicate their software because nobody other than employees knows how.
2. Companies based on tacit knowledge tend to look for employees willing to stay with the company for a long tenure in order to keep tacit knowledge within the business.

VII. What are some techniques startups use in order to manage uncertainty and information asymmetry?

A. It is important to start small and then grow from there.

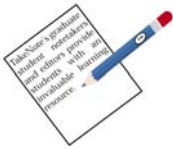
1. There are three main reasons why uncertainty and information asymmetry make it necessary for entrepreneurs to start small.
 - a) First, entrepreneurs must self-finance and therefore don't have access to enormous sums of capital.
 - b) Second, even if a startup does have investors, they won't offer large sums of capital all at once.
 - c) Third, entrepreneurs must minimize risk. The entrepreneur has less to lose in the case of failure if the enterprise is small rather than large.



- B. Another tactic is to form alliances and partnerships with established firms.
1. Alliances and partnerships are necessary for three main reasons.
 - a) First, they bring in assets that are needed to pursue short-lived opportunities.
 - b) Second, they provide the capital required to purchase needed resources.
 - c) Third, brand names are important in order to give the business idea value.
- C. Lastly, entrepreneurs must create legitimacy for the opportunity and the new venture.
1. Entrepreneurs demonstrate the legitimacy of their ideas in three main ways.
 - a) First, they can show conformity to existing rules and norms.
 - (1) One way that entrepreneurs show conformity is through wearing business suits when meeting with financial backers and customers, even if they don't necessarily wear them in the lab when developing the product.
 - b) Second, they can imitate the routines and procedures of existing firms.
 - (1) This gives the startup legitimacy and convinces others that it will succeed as well.
 - c) Fourth, they can engage in collective actions.
 - (1) One way to do this is through joining associations. An example of this is how wineries in the Finger Lake area become part of the Association of Wine Producers and Growers of the Finger Lakes.
 - (2) This creates legitimacy and provides access to resources, not all of which are financial. These resources might be too expensive for each person to have individually.
 - d) Fifth, they can obtain certification.
 - (1) This shows the world that they are a legitimate business.

VIII. There are three main take-aways from today's lecture.

- A. Sustainable competitive advantage is at the core of what allows a startup to succeed.
- B. In order to preserve your competitive advantage you can keep secrets, legally protect your ideas, start your business small, constantly engage in innovation, and create a solid reputation.
- C. You must, however, consider that you are small. Therefore, it is important to form alliances and create legitimacy and mimetics.



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Lecture Date: Thursday, September 13, 2007

Announcements:

- A fellow AEM professor came to the class to talk about two extra-credit experiments. For more information, visit www.pserc.cornell.edu/signup.leedr. If students participate in both experiments, they will receive one extra-credit point.
- A student spoke to the class about the Cornell Entrepreneur Organization. The first meeting will take place today after AEM 120 in PS143. Please email CornellEntrepreneurOrg@gmail.com with any questions.

I. We are going to start the class by listening to **Paul Joseph**, who first started a business that trained bartenders. He is now with the **Simon Management Group**.

A. The professor plays a video-clip of the interview.

1. Sun Microsystems just acquired one of his clients last year. Four men started the business from scratch in January 2000 and in just three years acquired enough value to sell it for \$200 million dollars despite the unfavorable economy.
2. Prior to founding the company, all four of the men had worked for either IBM or a division of IBM.
3. Although they all had ideas about where they company should go, the founders did research rather than making any rash decisions.
 - a) The engineer, the CEO, the CTO, and the marketing guy did just as much research as the management group that they had hired.
4. Common experience is critical to success.

B. What is interesting about this video-clip?

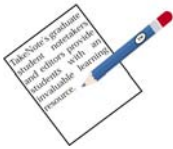
1. Instead of making hasty decisions, the four men looked for information in order to evaluate their ideas.
2. The founding team assisted the consulting team in their marketing strategy through a combination of research and experience.

II. Why do so many startups fail?

A. Many entrepreneurs who found new ventures to develop products or services do not do their homework. They fail to acquire essential information before beginning.

B. Successful products and services are based on real customer needs.

1. Entrepreneurs must know the business's customers, their needs, and how to approach customers in order to sell their idea.
2. If the entrepreneur does not have a solid marketing plan, the venture will fail regardless of the product, as nobody will know about it.
 - a) There are millions of brilliant products in the marketplace that do not succeed simply because people do not know about them.



- C. A real need exists when customers have a problem that needs to be solved, and that no existing products or services can solve.

III. Consumers often reject new products that offer significant improvements over existing products.

A. What are some examples of this phenomenon?

1. Carbonated drinks are the single most popular liquid in the United States, despite many tastier and healthier beverages. People simply are wedded to the idea of the carbonated drink and find it difficult to separate from that.
2. Petroleum has now reached \$80 per barrel; yet people still favor SUVs and large sedans over smaller hybrids. Again, this is a matter of consumer tastes and their unwillingness to change.
3. Another example is the Hershey's chocolate bar. Although there are many other brands of superior chocolate, consumers continue to favor Hershey's.

B. The explanation behind this phenomenon is that consumers psychologically overweight potential "losses" over potential "gains," by a factor of two or three.

1. Consumers are conservative, and therefore it is very difficult to change the way that they think.
2. Therefore, a new product must be ten times better than its predecessor.

IV. The "inside view" of new products differs from the "outside view."

A. An "insider," or innovator, has 5, 10, or 20 years of experience with the new product or technology.

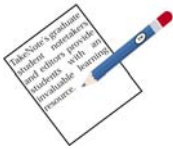
1. To them, the product's benefits and consumers' needs are obvious.
 - a) It is necessary to educate consumers, who may not think that the product's superiority is evident. You must be able to convince the customer of your point of view.
 - b) Starbucks successfully executed this when it educated the United States on the espresso as an alternative to a regular cup of coffee.
2. The insider fully trusts the product and is a self-selected believer in its necessity.
3. The insider believes that the status quo includes the product's new features.

B. An "outsider," or customer, is seeing the product for the first time.

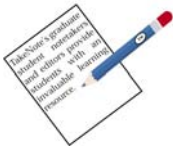
1. Consumers' needs are not obvious to them, and they are skeptical of the entrepreneur's claims.
2. The outsider feels that the status quo includes existing, rather than new, features.

C. The developer has a "curse" that makes it difficult to sell his/her idea.

1. Because it is so easy to get enamored by your own idea, an entrepreneur can become so embedded in his/her product that he/she cannot approach it from an outsider's point of view.
2. Developers systematically underestimate the difficulty first-time buyers have in understanding the new product or technology.



- V. First, the entrepreneur must develop consumers' real needs.
- A. The first step is to identify a customer problem.
 1. Generally the best way to do this is to “scratch your own itch,” or in plain terms, come up with a solution to one of your own problems.
 2. What is an example of an itch?
 - a) A girl in the class comes up with the problem that there is no real way to keep time while taking a shower.
 - b) The founder of Nike made shoes for his runners, who previously wore shoes that easily broke and were difficult to break in. This was a solution to his own “itch.”
 - B. After you finding a problem, the entrepreneur must formulate a solution to his/her problem.
 1. The student, who is concerned about telling time in the shower, comes up with the solution of embedding an alarm clock into a shower caddy.
 2. Another example is eBay. The founder first developed the website in order to help his wife acquire Pez dispensers.
 - C. Then, the entrepreneur has to determine whether or not the solution is feasible.
 1. Economics, pricing, and costing must all be taken into consideration.
 - a) In the case of eBay, these were not significant concerns.
 - D. Finally, the entrepreneur must identify current or potential alternatives.
 1. He/she should answer the question, “Does the new product or service offer a real improvement?”
 2. Technically, there are other solutions to not being able to tell time in the shower. One solution is a waterproof wristwatch.
- VI. After determining real needs, the next step is to assess consumer preferences.
- A. First, the entrepreneur should evaluate the target market.
 1. What is the target market for the alarm clock-shower caddy idea?
 - a) Possible markets include college students, business people, etc; essentially the market is anybody who is pressed for time, yet simultaneously enjoys taking lengthy showers.
 - B. Next, the entrepreneur should determine the type of new product or service he/she is developing.
 - C. Finally, he/she should consider whether the solution to customer needs is already understood, or if he/she has a novel solution to the problem.
 1. An example of a product that offered a novel solution in its time was the PDA. The PDA allowed customers to keep their schedule and contacts electronically with them at all times.
 - a) The PDA offered a real solution to the Rolodex.



- VII. In order to collect the necessary marketing information, the entrepreneur should try to answer three crucial questions.
- A. Who are the potential customers?
 - 1. It is important to segment the market into tight niches.
 - 2. Who are the potential customers for the alarm-clock shower caddy?
 - a) Perhaps the target market is freshmen and their parents.
 - B. How will potential customers react to the new product or service?
 - 1. Freshmen’s parents might be very interested in the alarm clock shower caddy because they have an interest in making sure that their children arrive at class on time.
 - C. What can you learn about specific markets or geographic areas?
 - 1. Ithaca would not be a good starting market to sell the shower caddies because of its size. Instead, a better market would be a big city such as New York City, Boston, or Chicago, which have lots of colleges and students.

VIII. The market determines the research techniques that you should use.

A. Refer to the following chart:

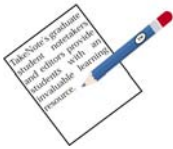
	Existing Market	New Market
Philosophy of market research	Deductive data analysis	Intuition
Techniques for gathering customer information	Focus groups, surveys, mall studies	Industry experts, trend extrapolation, future scenarios

- B. If the product caters to an existing market, you are able to be more specific in your approach.
 - 1. The alarm clock shower caddy fits into this category.
 - 2. Because startups often lack a significant amount of capital, entrepreneurs must be flexible in their research techniques.
- C. EBay, by comparison, fits into the “new market” category in that there was no real existing customer base prior to its creation.

IX. Three types of direct research techniques are **surveys**, **perceptual mapping**, and **focus groups**.

- A. **Consumer surveys** allow potential customer to compare your product with existing ones.
 - 1. The target group rates different dimensions of the product on a scale from low to high.
 - 2. This technique assumes that you already know the dimensions that customers will use to evaluate your product.
 - a) What are some dimensions of the shower caddy idea?

(1) Some dimensions include appearance, durability, size, etc.



3. The benefit of surveys is that they allow entrepreneurs to collect much information about consumer preferences.
4. A drawback to consumer surveys is that they are not useful if an entrepreneur fails to identify a crucial dimension.
 - a) Perhaps the answer to not being able to tell time in the shower is not a shower-caddy, but a whole new product altogether. Consumer surveys will not tell you this.

B. A second option is focus groups.

1. Focus groups are made up of 8 to 12 people who are similar to potential customers.
2. The group will then meet for 1 to 2 hours in order to discuss their perceptions of and reactions to the relevant products.
3. During the session, the participants will identify the key dimensions along which they perceive and evaluate various products.
 - a) The benefit to this technique is that there is no need for the entrepreneur to identify dimensions in advance; the group will do this for you.
4. A potential drawback of focus groups is that an independent dynamic will form in each group that is unlikely to be uniform.
5. One technique used in focus groups is called the **repertory grid**.
 - a) Each product is listed on a separate index card.
 - b) Three cards are subsequently chosen, and then group members describe ways in which any two products are similar and the third is different.
 - c) This technique aids in identifying dimensions along which people perceive the product.
6. Another technique used by entrepreneurs is called **conjoint analysis**.
 - a) This method asks individuals to express their preferences for various products, which are specifically chosen in order to offer a systematic array of features.
 - b) The purpose is to determine the relative importance of each dimension for consumers.
 - c) Conjoint analysis uses a fractional factorial design based on the results of perpetual mapping.

X. Entrepreneurs can also use indirect research techniques.

- A. Indirect techniques examine secondary data, which includes sales of competing products, demographic data, and trends.

XI. The take-away of this lecture is that it is important to for entrepreneurs to do their homework before launching a new venture.