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Effectuation principles supporting young underserved entrepreneurs

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Not all entrepreneurs can tap into large funds, which does not mean that they cannot be successful. Young entrepreneurs can start small with who they are, what and whom they know and then focus on downsizing the risk. This paper provides an overview of tools and methodologies that can be applied in the three business creation phases orientation, planning and testing, as well as in sustaining a growing of the created enterprise. The effectuation tools are linked to topics addressed in business planning and lean start-up. These tools should be helpful when supporting NEETs aiming to start a business, as the approach targets using the means which the young entrepreneurs have already available. We are heavily drawing on the work of Sara Sarasathy¹, Stuart Read² and Thomas Belkman³ and highly recommend them for further reading and viewing.

The focus of this paper is phase I (orientation and idea generation) and phase II (planning testing and building) of the business creation process. Here the effectuation tools are extremely helpful. For Phase III (sustain and grow) of the business creation, we recommend mentoring as the preferred support tool for the young entrepreneur. Mentoring is presented in several other Thinking Space Papers⁴ on the YES! Peer Learning Platform.

Phase I – orientation and idea generation

This phase is all about interest, motivation, opportunities, ideas as well as personal and financial obstacles. Traditional business planning works with short presentations on the customer's problem, the proposed solution and the benefits to the customer in terms of time, money, prestige, health, etc. The lean start-up method focusses on the customer development by testing assumptions based on the Business Model Canvas Model created by Alexander Osterwalder⁵.

Birds in the Hand Principle

Using the effectuation heuristic, entrepreneurs need to answer the key questions before starting a business: who am I?, what do I know?, whom do I know? Starting from the identified available means

¹ Sara Sarasvaty's research concluded that master entrepreneurs rely on effectual reasoning. Brilliant improvisers, they constantly assess how to use their personal strengths or whatever resources they have at hand to develop goal on the fly, while creatively reacting to contingencies; <https://www.effectuation.org/> ; or her inspirational talks at TEDxMidAtlantic 2010 <https://www.youtube.com/watch?v=t5HZW4NqZ-E> .

² Very inspirational series of five videos of Stuart Read (IMD) on the effectuation principles, e.g.: at: Part 1 - Freitag (Start With Your Means: The Bird In Hand Principle) by IMD Prof. Stuart Read, <https://www.youtube.com/watch?v=DnGrcCVG8TE&t=97s> .

³ Particular credits to Thomas Bleckmann who explains the effectuation principles on his website and provides extensive further reading and case studies: www.effectuation-intelligence.nl

⁴ See: https://youngentrepreneursucceed.com/space_category/mentoring/

⁵ <https://www.businessmodelsinc.com/about-bmi/tools/business-model-canvas/>

and contacts – the birds in hand – the entrepreneur imagines possibilities and takes action. Often the entrepreneur starts very small to move directly into implementation without elaborate planning. Very inspiring is the case of the Swiss Freitag brothers, who started their business with producing weather proof bags for bike messengers from recycled truck tarp.⁶ Starting from what they knew and what they had at hand for free, they developed eventually a business using the trends of recycling and individualisations. Some of their bags are by now museum pieces.

**OVERVIEW OF TOOLS AND METHODOLOGIES
SUPPORTING ENTREPRENEURS**

TIME-LINE	TOPICS	TOOLS	BUSINESS PLANNING	LEAN START-UP
PHASE 1 Orientation, idea generation	Interest, motivation, opportunities/ ideas, obstacles (personal, financial) What do I have? What do I know? What would I love to do?	Semi-structured interviews (pre- defined set of questions) Effectuation: Bird-in-Hand Principle	Short presentation: customer's problem; solution; customer's benefits (time, money, prestige, health)	Customer Development (testing assumptions based on Business Model Canvas (BMC): value proposition, customer pains/gains
Selection PHASE 2 Planning, testing, building	Business idea, products, customers, marketing, sales, production, internal service, financial planning	Effectuation: - Bird-in-Hand Principle - Affordable Loss Principle - Crazy Quilt Principle - Lemonade Principle - Pilot in the Plane Principle Design Thinking	a) Mission, vision, competences, milestones, legal form, partners b) product & product development products, services, modules, bundles	BMC: Value Proposition Customer Development: Minimal Viable Product (MVP) BMC: Value Proposition
		Effectuation: - Pilot in the Plane Principle	c) Marketing & sales customer segments, channels, competition, advertising, sector	BMC: Customer segments, Channels, Customer segments, key activities CD: Customer Discovery - Customer Validation - Customer Creation
		Effectuation: Crazy Quilt Principle	d) Production: office, location, partners, equipment, materials, quality assurance, staff	BMC: Key resources, Key partners
		Effectuation: - Pilot in the Plane Principle - Lemonade Principle	e) Internal service administration, financial management, risks, insurance, human resources	BMC: Key resources
		Effectuation: - Affordable Loss Principle	f) Financial planning: gross margin plan, financing plan, capital requirement plan, profit margin, profit contribution; time, capacity planning; liquidity planning; revenue plan	BMC: - Key activities; - Cost structure; - Revenue streams
Decision PHASE 3 Sustain and grow	Apply knowledge, find customers, production, deliver services Access to finance	Mentoring	Access to finance: (loans/ investments requires business plan) - micro loans, promotional loans	Access to finance: Crowd-funding Micro-Crowd Beehive Model

Source: Jörg Schoolmann, Presentation at the YES workshop in Barcelona, June 2019.

Phase II - Planning, testing, building

In this phase the business model or value proposition is developed. Here, all five effectuation principles play an important role. The bird in the hand principle, described in the previous section is helpful for the definition of the mission, vision, competence and potential partnerships. The aim is not a great long-term vision but a start with available means and the creative use of them.

The other four effectuation principles that help the entrepreneur in setting up his business set-up are:

⁶ <https://www.freitag.ch/en>;

Affordable Loss Principle

This principle is useful not only when looking at finance but when focussing on a predetermined level of affordable loss or acceptable risk⁷. Together with the Bird in the Hand Principle it is the decisive principle in effectuation for developing a business idea.

As the future in an ever-changing world is unpredictable, effectuation promotes to take control by choosing organic and preferably validated learning; smaller investments allow entrepreneurs to gain insight by moving forward in an affordable way. The affordable loss principle depends on the person, not on new venture opportunities, which are difficult to value upfront, whereas the investment of time, money and other resources is measurable and controllable. Because estimates of affordable loss are about the entrepreneur's own life, commitment and values, the entrepreneur has some control, to drive decisions about which venture to start. The focus is on cultivating opportunities that have a low failure cost and generate more options for the future. The combination enables less costly failure and learning that can be applied to the next iteration of the opportunity. The entrepreneur can apply it by asking⁸:

- Can I afford (financially) what I am investing in this initiative? How much am I willing to lose?
- Am I comfortable that the investment steps are worth taking, even if I lose all of it?
- How could I decrease actual cash outflows on this venture – and continually strive to drive it to zero?

Crazy Quilt Principle

The Crazy Quilt Principle is all about turning to collaboration when creating a business in particular for developing the value proposition and organising production. Each piece of cloth of the quilt symbolises a partner sewed together in a pattern of commitments to each other. It is a helpful tool for creatively expanding own means by - for instance - involving partners in the development or production of a product/service or quality insurance. Used or recycled equipment, a relatives' location might be a free of charge or inexpensive resources to limit risk and investment in the venture and allow to take the next step with minimal uncertainty.

The crazy quilt principle on effectual reasoning focuses on building partnership rather than beating competitors. It complements the Affordable Loss Principle as an assessment approach for opportunities and a way to bring the entrepreneur's idea to market with very little cash expenditure.⁹ This can be done by segmenting the initial list of 'Who do I know?' (Bird in Hand Principle) into who can:

– help with developing a better understanding of markets and customer needs

⁷ N.Dew, S Sarathy, S.Read, R.Wiltbank (2009) Affordable Loss: Behavioural Economic aspects of the Plunge Decision, Strategic Entrepreneurship Journal, J.3, p.111, at: <https://www.effectuation.org/?research-papers=affordable-loss-behavioral-economic-aspects-of-the-plunge-decision>

⁸ N.Dew et al (2009), p.119 at: <https://www.effectuation.org/?research-papers=affordable-loss-behavioral-economic-aspects-of-the-plunge-decision>. A very helpful source: <http://www.effectuation.nl/en/corporate-effectuation#/affordable-loss-principle>.

⁹ <http://www.effectuation.nl/en/corporate-effectuation#/crazy-quilt-principle>; https://www.effectuation.org/?page_id=4055&principle=crazy-quilts with further reading and case studies.

- help developing fresh ideas
- tell you who you need to know and who does what
- is able to facilitate and connect you to people who can help
- provide constructive feedback, challenge decisions and thinking
- strengthen your solution finding capacity.

Lemonade Principle

The Lemonade Principle is about leveraging surprises, learn from them and adapting. If there is a lemon that convinces you to abandon your project or venture, “slice the lemon and juice it. Study the juice and understand what the lemon is trying to teach you. It should offer you directions to change course and not simply abandon the ship.”¹⁰ The principle is particularly helpful when defining the value proposition as, for instance, discussions with potential customers might bring unexpected surprises.

Meeting more people, being open to new experiences and framing surprises that at least have a potential to be an opportunity, are advantages, that enable people to turn surprises into opportunities. For this to happen, you don't have to be a positive person, what you make out of the surprise will be just different. The question to ask when the surprises arise: How to turn the surprise into an opportunity and maybe contribute to society?

Pilot in the Plane Principle

The Pilot in the Plan Principle simply means that the entrepreneur is in charge of his venture. He/she needs to make it happen. The entrepreneur's means provide the starting point. The action begins in earnest when the entrepreneur begins interacting with people to sharpen the initial idea, bring people on board, find partners, etc.

The start-up phase of a new business is an extremely uncertain and unpredictable situation for any entrepreneur. The effectuation principles are tools to limit the risk. They are mutually reinforcing and can be linked to more classical business model approaches or the lean start-up model that is required to access (public) funding. The method and its logic are particularly suitable for NEETs, as it facilitates business creation with very limited means. They limit the risk of the entrepreneur in a volatile world and make the plunge into a venture less scary.

¹⁰ <http://www.effectuation.nl/en/corporate-effectuation#/lemonade-principle>