THE ENTREPRENEURIAL METHOD:
HOW EXPERT ENTREPRENEURS CREATE NEW MARKETS

For several centuries, people “did” science without explicitly understanding the scientific method. Prevalent explanations for discoveries consisted either in some kind of magical, mystical abilities possessed by certain individuals and not others, or were based on chance, fate, and circumstance. Some people were said to be able to “read the signs” of nature; or were geniuses who leapt out of bathtubs shouting “Eureka!” It was only when Roger Bacon and later Francis Bacon and others began spelling out elements of the scientific method—observing, hypothesizing, testing, revising the hypothesis, reaching valuable conclusions—that science came out of the realm of personality and into the modern age of science education. Today we believe that the scientific method is both teachable and learnable for the most part. That does not mean that we can produce an Einstein on demand. But we know that scientific genius is neither a necessary nor a sufficient condition for doing good science.

We can make a similar case for entrepreneurship. Although well-known feats of entrepreneurship such as Apple, eBay, and Starbucks might still be a matter of luck and/or genius, we can still teach and learn the entrepreneurial method. And just as the scientific method helps us to harness the potential of nature, the entrepreneurial method enables us to unleash the potential of human nature.

Furthermore, just as the scientific method is fueled by the logic of experimentation, the entrepreneurial method operates through the logic of effectuation.

Elements of the Entrepreneurial Method

In sum, researchers have traditionally studied entrepreneurship as either (1) a set of personality traits that explains the success or failure of the firms an entrepreneur creates or (2) a set of circumstances or attributes giving rise to the opportunity and the environment that contains the seeds of a venture’s success or failure. In the former case, potential entrepreneurs either have the right traits, or they don’t. And if they don’t, they are urged to cultivate them. In the latter, potential entrepreneurs are called on to develop strategies and skills for recognizing, identifying, and exploiting high potential opportunities.

Recently, however, there has been a new focus on entrepreneurial expertise. Expertise consists in tacit as well as learnable and teachable aspects of experience that are related to high performance in specific domains. Instead of taking either traits or circumstances as inputs and trying to explain variance in performance, the expertise lens focuses on understanding
commonalities across a variety of experts in a single domain, given high levels of performance.

As a result of in-depth studies of how expert entrepreneurs act, think, and decide in the early stages of creating new ventures, elements of the effectual logic they use are beginning to be clarified. Those elements have also begun to be evidenced in the early histories of new firms and new markets/industries. We can summarize the results so far in three parts as follows:

**Process Elements**

- Expert entrepreneurs begin with who they are, what they know, and whom they know, and immediately start taking action and interacting with other people.
- They focus on what they can do and do it, without worrying much about what they ought to do.
- Some of the people they interact with self-select into the process by making commitments to the venture.
- Each commitment results in new means and new goals for the venture.
- As resources accumulate in the growing network, constraints begin to accrete. The constraints reduce possible changes in future goals and restrict who may or may not be admitted into the stakeholder network.
- Assuming the stakeholder accumulation process does not prematurely abort, goals and networks concurrently converge into a new market and a new firm.

The process is graphically represented and explained in greater detail later in this note.

**Principles**

At each step of the process, expert entrepreneurs use the following principles. Each principle inverts key decision-making criteria in conventional management theories and practices.

*The crazy quilt principle* is a principle of means-driven (as opposed to goal-driven) action. The emphasis here is on creating something new with existing means than discovering new ways to achieve given goals.

*The affordable loss principle* prescribes committing in advance to what one is willing to lose rather than investing in calculations about expected returns to the project.

*The bird-in-hand principle* involves negotiating with any and all stakeholders who are willing to make actual commitments to the project, without worrying about opportunity costs or carrying out elaborate competitive analyses.

Furthermore, it is who comes on board that determines the goals of the enterprise, not vice versa.

*The lemonade principle* suggests acknowledging and appropriating contingency by leveraging surprises rather than trying to avoid them, overcome them, or adapt to them.

*The pilot-in-the-plane principle* urges relying on and working with human agency as the prime driver of opportunity rather than limiting entrepreneurial efforts to exploiting exogenous factors such as technological trajectories and socioeconomic trends.

Each of those five principles embodies techniques of *nonpredictive control*—reducing the use of predictive strategies to control uncertain situations. If we organize strategies along the dimension of prediction and control as in *Figure 1* below, expert entrepreneurs prefer the bottom right hand quadrant both in terms of the problems they seek to solve and the solution strategies they prefer.
Effectual Logic

Effectuation is the inverse of causation. Causal models begin with an effect to be created. They seek either to select between means to achieve those effects or to create new means to achieve preselected ends. Effectual models, in contrast, begin with given means and seek to create new ends using nonpredictive strategies. In addition to altering conventional relationships between means and ends and between prediction and control, effectuation rearranges many other traditional relationships such as those between organism and environment, parts and whole, subjective and objective, individual and social, and so on. In particular, it makes those relationships a matter of design rather than one of decision.

In general, entrepreneurs use both causal and effectual approaches, in a variety of combinations. Use of and preference for particular modes is related to the entrepreneur’s level of expertise and where the firm is in its life cycle. Expert entrepreneurs, in particular, are good at using all four logics and knowing when to use which one. That is why it is important that they overwhelmingly prefer an effectual logic in the 0 to 60 m.p.h. phase of starting new ventures.

Figure 1: Taxonomy of logics.
certain criteria over others in fabricating and implementing new solutions. Logical framing matters because it makes a real difference in the world and makes a world of difference in the reality entrepreneurs perceive and make possible or impossible.

**An example of the entrepreneurial method**

Take the case of Starbucks. Conventional wisdom tells the following story:

- Howard Schultz built Starbucks into a nationally known brand name. How did he do that?
- First, he recognized that baby boomers were rejecting processed and prepackaged foods in favor of more “natural” and higher-quality foods and beverages.
- Second, he saw that Americans were becoming more interested in a higher level of service than was generally available in most retail outlets.
- Schultz used that understanding of the changing demand side—in tandem with a range of operating policies—to develop premium coffee products and appealing retail environments.

But consider also the following historical facts:

- By the 1980s, per capita coffee consumption in the United States, which was based largely on supermarket sales of one-pound cans from Maxwell House and other mass marketers, had been declining for 20 years.
- The original Starbucks was founded in 1971 by Gordon Bowker, Jerry Baldwin, and Zev Siegl. It consisted of a shop in Seattle’s Pike Place Market that sold high-quality roasted beans, along with tea, spices, and supplies; it did not sell coffee by the cup.
- As Schultz himself states, “But the founders of Starbucks were not studying market trends. They were filling a need—their own need—for quality coffee.”
- Even Bowker and his partners were not the first to “discover” the specialty coffee market—Alfred Peet, the Dutch coffee connoisseur, had been at it since 1966. And it appears likely that there were others before him.
- Schultz, unlike Peet or the original founders of Starbucks, was not a coffee aficionado. “Like most Americans in the early 1980s, he had grown up thinking of coffee as a commodity purchased along the inner aisles of supermarkets.” (Koehn, 219) He was an executive with the housewares supplier Hammerplast, whose clients included the original Starbucks company.

As we look into the facts of the Starbucks story, how can we understand the development of the specialty coffee market, or the creation of Starbucks as we know it today? More important, how can we understand the decisions and actions of expert entrepreneurs and the logic that drives them?

Was there or wasn’t there a market for Starbucks, independent of Schultz’s actions? Taking into account the data available in 1981, could he rationally have predicted that market? If not, did he merely act irrationally, or randomly, stumbling upon a market someone would eventually have discovered anyway? For example, we could argue that Schultz could not have acted rationally, because he could not have predicted a market where people would pay exorbitant prices for coffee. Here are data to support that:

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1 Details of the history of Starbucks have been taken from Nancy Koehn’s account in *Brand New: How Entrepreneurs Earned Consumers’ Trust from Wedgwood to Dell* (Cambridge, MA: Harvard Business School Publishing, 2001) as well as from Howard Schultz’s own in *Pour Your Heart Into It: How Starbucks Built a Company One Cup at a Time* (New York: Hyperion, 1997).
During the next two decades [the 1960s and 1970s], the large roasters continued to spend huge advertising budgets fighting for shares in a shrinking market. Per capita coffee consumption began to fall in the mid-1960s, declining from a postwar peak of 3.1 cups per day in 1963 to less than 2 cups in the mid-1980s. Americans, especially teenagers, who had historically drunk coffee, increasingly consumed other beverages, especially soft drinks such as Coke and Pepsi. By the late 1980s, about half the U.S. population over the age of 10 did not consume coffee. Long the nation’s number one beverage (excluding tap water), coffee had dropped to a distant second behind soft drinks. (Koehn, 213)

At the same time, other data could be used to argue that Schultz did not act irrationally or randomly. Consider how he built his first coffee bar, Il Giornale, which was later merged with the original Starbucks in 1987:

The entrepreneur and his team listened carefully to patrons and each other in the months after Il Giornale opened. Consumers, they discovered, did not like nonstop opera music. Those interested in lingering in the store desired chairs. Some asked for flavored coffee. A menu printed primarily in Italian was not accessible to many people. The baristas’ bow ties were uncomfortable to wear and difficult to keep looking neat after hours in front of the espresso machine.

Schultz considered each of these issues. He wanted to please consumers. But he had to do so in a way that was consistent with the offerings and distinct identity that he was trying to create. He adjusted many operating policies in response to customer and employee feedback. Il Giornale began providing chairs and playing more varied music. The baristas stopped wearing ties. “We fixed a lot of mistakes,” Schultz said. But he decided not to honor some requests. For example, although the larger market for vanilla, hazelnut, and other artificially flavored beans was growing rapidly, the company consistently refused to sell coffee brewed from them. Schultz believed the practice would compromise his organization’s commitment to selling an authentic, high-quality product and thus its brand’s developing image. (Koehn, 213)

Indeed, the story of Starbucks, like the story of many enterprises, is full of feedback from the so-called “market” that, in hindsight, may or may not have proved useful or wise. Clayton Christensen, in his book Innovators’ Dilemma, has chronicled several recent cases in point, where feedback from customers led to the failure of leading firms, opening up new markets to which the same customers eventually migrated. The confusion inherent in the information available to Schultz did not consist solely of the profusion of market feedback. It extended to feedback from other stakeholders, including investors, employees, and strategic partners. For example, while the founders of the original Starbucks would not agree to convert their enterprise into an Italian-style coffee bar business, they did offer Schultz seed money and advice to found Il Giornale. Similarly, of the 242 men and women he approached for funding, 217 decided not to fund the venture, but the others did purchase equity. The weight of the evidence was against him—yet there was enough support to indicate that his actions were not random or irrational.

So, how is an entrepreneur to decide which opportunities to pursue and how to do so? The answer is simple, based on studies of entrepreneurial expertise: Effectuators do not wait to “discover” the perfect opportunity. They make that opportunity effectually along with other effectuators who self-select into the

Distinguishing Characteristic:
Imagining possible new ends using a given set of means.
process of creating new opportunities, ventures, and markets.

**Dynamic model of effectual logic**

As Figure 2 shows, the dynamic process begins with three categories of means: Identity, Knowledge, and Networks. Effectuators begin with who they are, what they know, and whom they know and act on things they can do without worrying too much about what they ought to do. That reflects an emphasis on future events they can control rather than those they can predict.

In the next step of the process, effectuators start reaching out to other people with a view to obtaining advice and other inputs on how to proceed with some of the things they could (possibly) do. The people they interact with could be potential stakeholders, friends and family, or random people they meet in the routines of their lives. As they find people who want to participate in the efforts to build something (at this point the “something” may be vague or concrete, but is always very much open to change) they move toward obtaining actual commitments from them. In this step, what counts is the willingness of stakeholders to commit to the construction process; and not their fit with or alignment to some preconceived vision or opportunity. Each person who actually stakes something to come on board contributes to shaping the vision and the opportunity, as well as enabling and executing particular strategies to achieve them. Whatever each stakeholder commits becomes a patch in a growing quilt whose pattern becomes meaningful only through the continual negotiation and renegotiation of its appeal to new stakeholders coming on board. In other words, stakeholders commit resources in exchange for a chance to reshape the goals of the project, to influence what future will ultimately result.

That process of negotiation and persuasion sets up two cycles in the concurrent formation of new firm and new market: an expanding cycle that increases the means available; and a converging set of constraints on the goals of the growing stakeholder network. Those constraints help solidify structures of the new market as well as to clarify and reorder the preferences of stakeholders in the market. At some point in the process, the converging cycle ends the stakeholder acquisition process; there is no more room for negotiating and maneuvering the shape of what will be created, and path dependency takes over. As the structures of the market begin to take visible shape it becomes important to re-evaluate the balance of prediction and control in the venture’s strategies.
Stakeholder commitments drive the dynamics of the effectual model. More fine-grained details of the dynamic model are provided by three key principles that stakeholders use. These principles provide criteria for taking effectual action and help stakeholders decide how to make effectual commitments:

**Means-driven (rather than goal-oriented) action:** Each effectual stakeholder considers who he or she is, what he or she knows, and whom he or she knows. Stakeholders imagine possible courses of action based on their means and engage others whose strategies are driven by other types of identity, knowledge, and networks. When exciting overlaps are discovered and valuable new combinations are engineered, stakeholders commit those elements of their means that make worthwhile contributions to the new world being fabricated, thereby enabling that fabrication. Initially, every stakeholder interaction is as likely to change the shape of the new market being created as it is to change the original set of means. That makes the process doubly nonpredictive and hence increases the possibility of genuine novelty.

**Affordable loss (rather than expected return) as an investment criterion:** Each effectual stakeholder strives to invest only what he or she can afford to lose. Because it is not clear at the early stages of the effectual process what the pie will be, let alone how much each piece will be worth later on, stakeholders cannot effectively use expected return as their immediate criterion for selecting resource investments. Instead, they have to reconcile within their own minds whether they can live with the loss of what they are investing in the enterprise. That takes away the need to predict what the returns will be; calculation of affordable loss depends only on the investor’s current situation and a variety of subjective variables.

**Leveraging (rather than avoiding) contingencies:** Any environment and epoch in human affairs contains unexpected contingencies. That is why all predictions come with disclaimers about degrees of confidence. Whereas predictive efforts seek to avoid or hedge against contingencies, effectuation seeks to capitalize on those occurrences. In other words, surprises can offer unexpected opportunities as well as present unanticipated problems. Contingencies don’t merely undermine the value of current means in achieving given goals, they also provide opportunities to create new value through those means in pursuit of new goals. Therefore, stakeholders in the effectual process deliberately keep open room for surprises.

In the final analysis, the dynamics of an effectual logic are propelled by sufficient conditions for the creation of new ventures and new markets, not through necessary conditions. In other words, Howard Schultz built Starbucks by finding and working with enough interested stakeholders who were willing and able to invest enough to make the venture viable. If he had weighed all the evidence—both for and against the potential opportunity for Starbucks—and waited to discover all necessary conditions for the success of his venture, we might still be drinking the muddy coffee that comes out of cans on grocery store shelves.

**Conclusion**

We can view entrepreneurship not as a tool or a destination, but as a method akin to the scientific method for the making as well as the finding of valuable new opportunities. Just as scientists employ the experimental logic of hypothesis testing to discover valuable new truths about nature, entrepreneurs use an effectual logic to stitch together stakeholder networks that make new value from the creativity inherent in human nature. An important idea here is that all human beings have this creative potential—the entrepreneurial method simply unleashes it in a systematic way. Science may or may not succeed in achieving any of its much-touted targets, such as
discovering a grand unified theory of everything or the irreducible code of life itself. Nor can it guarantee that its applications will result in a better world, however defined. Yet, its potential for any good at all derives from its being a method and a worldview, a process involving a logic that can be taught and learned by an increasing variety of individuals who can make a variety of contributions that, on average, begin to look very much like progress over time.

One measure of that progress is how well it helps us to harness the potential of nature for the achievement of our ends. Similarly, we may reconceptualize entrepreneurship as a method for unleashing human nature to achieve, transform, and generate our ends. Specification of an effectual logic is a useful step in this reconceptualization.