

# Opportunity Assessment: Considerations for Entrepreneurs

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Defining entrepreneurship can be problematic and maybe sometimes misleading. For example, the assertion that entrepreneurship is concerned with the discovery and exploitation of profitable opportunities does not appear to take account of the notion of risk, which because of uncertainty is always inherent in new market decisions. This is borne out by reality, where evidence indicates that a large percentage of start-ups (often thought to be between 50% and 70%) fail within the first 5 years. This fact, coupled with research suggesting that idea generation, by itself, is not an issue, implies that the key challenge lies in the effective evaluation of those ideas. This means that entrepreneurs must be honest with themselves and objectively assess whether they have identified a viable business opportunity, as distinct from a good idea with limited or no commercial prospects. This is particularly important for technology entrepreneurs as the lead time to market is often long and the risk of failure is high. Central therefore to the resulting opportunity confidence leading to adoption or rejection of an idea is an iterative process of evaluation, which in the first instance is critical in nascent entrepreneurial processes. Three key constructs—opportunity costs, market assessment and financial analysis—are of singular importance in the evaluation process and are discussed in more detail below.

Keywords: opportunity cost ; market assessment ; financial analysis ; nascent entrepreneurship

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## 1. Opportunity Cost

Opportunity costs are considered to be the foregone benefit of the next available alternative as a consequence of making a choice <sup>[1]</sup>. In general, this refers to the cost of an alternative that must be relinquished in order to pursue a certain action and includes items such as income and perceived security from alternative employment, personal liquidity changes, and alternative career development opportunities. That is not to say that the opportunity cost of new business venturing represents a dichotomous choice between entrepreneurship and non-entrepreneurial activity.

For example, many individuals begin the process of new venture creation while maintaining regular employment <sup>[2]</sup>. This can have the effect of lowering opportunity costs because the part-time or hybrid entrepreneur does not forgo an income, and at the same time may increase human capital through continued learning <sup>[3][4]</sup>. Choice-making is also necessary in the context of preference for specific entrepreneurial ventures, and so for existing or experienced entrepreneurs, selecting from among several viable ventures also creates an opportunity cost when evaluating those opportunities <sup>[5]</sup>. Additionally, opportunity cost-based decisions form part of the early-stage processes because entrepreneurs are resource-constrained <sup>[6][7][8]</sup> and therefore not only have to choose between alternative projects but also have to decide between applying resources to further opportunity evaluation or opportunity exploitation <sup>[9][10]</sup>.

Theorists suggest that individuals engage in a form of cost-benefit analysis in which current opportunities and their returns are compared to prospects associated with alternative opportunities <sup>[11][12][13][14]</sup>. Sometimes this evaluative exercise may be informal or unscientific <sup>[15]</sup>, although the process tends to become more formal once the application of resources (other than the entrepreneur's time) is factored into the equation. Often these costs are financial in nature. For example, Amit et al. <sup>[12]</sup> used the opportunity cost framework to study the transition to entrepreneurship from salaried or paid employment. They found that the individuals who started new ventures had lower income compared to those who chose to remain in paid employment, a finding mirrored in Cohen's <sup>[16]</sup> classic work. A similar financial formulation of opportunity cost is evidenced in situations where entrepreneurs invest their personal funds or personally guarantee borrowings when starting a business <sup>[17][18]</sup> or where they incur unlimited liability resulting from the debt structure of the business <sup>[19]</sup>.

However, opportunity cost in the context of entrepreneurial intention is a multi-dimensional construct. Cassar <sup>[1]</sup> explored indicators of household income as a proxy for the financial dimension along with influences such as the education level of the entrepreneur and their managerial experience—effectively introducing the notion of human capital as a dimension of opportunity cost. Defining human capital as “the extent to which an individual has invested in their knowledge and can

subsequently apply such knowledge to tasks as required”, he goes on to assert that individuals with greater human capital levels incur greater opportunity costs when starting a business because they have better alternatives available to them. However, entrepreneurial activity can, in turn, increase human capital [20] which is of major significance given the assertion that individuals that possess it, on average, possess better judgment and evaluative skills [21] and are more likely to become entrepreneurs in the first instance [18]. This view is consistent with Shane and Venkataraman’s [17] seminal work which asserts that human capital in the form of learning, reduces the cost of exploiting an opportunity when the learning or experience is transferrable.

While studies commonly assess human capital using measures around education level, start-up experience and industry experience and combine it with specific factors such as ‘bank connections’ [22], a wider view is taken in some studies. For example, in one study the concept of ‘Pre-Venture Managerial Experience’ (PVME) is explored and found to be relevant in several aspects, namely; the decision to engage in entrepreneurial activity, the goals set for the new venture and the level of risk that is acceptable [23]. Other authors concur with PVME theory concluding that it drives overall expectations, scope, and direction [24][25][26][27][28]. This is because individuals who have extensive managerial experience typically enjoy high earnings and usually also have several career alternatives available to them. Since technology innovation start-ups are typically characterized by high potential returns, they are likely to be appealing especially to those with high pre-venture experience.

However, studies around the impact of opportunity cost and human capital are not exclusively concerned with the intention to engage in entrepreneurship, often resulting in disparate findings. Hormiga et al. [14] found an additional influence—the propensity to innovate, and Arora and Nandkumar [13] found that people with greater opportunity cost tended to operate to a different planning horizon and were more likely to ‘cash-out’ sooner. In the realm of experience and education, there is also a lack of unanimity. For example, while many support the proposition that entrepreneurs gain important insights from applicable prior experience [29][30][31][32][33][34] others do not. On the one hand, empirical studies have shown that experience is associated with greater task performance, including forecasting ability [35][36][37] but on the other hand, such claims are disputed by those who argue against the benefit of experience, due to the heterogeneity across tasks limiting transferability of knowledge [38][39][40], the lack of task repeatability [41][42] and cognitive biases that may inhibit learning [43][44][45][46].

Notwithstanding these debates, the literature reviewed for this study found only limited empirical research that directly investigates the influence that experience has on entrepreneurs’ new business expectations and judgments, with inconclusive findings. This alone provides a compelling reason for addressing this topic in the current work. In addressing it, various dimensions of the construct and their place in the literature are outlined in **Table 1**. These dimensions are tested in our fieldwork.

**Table 1.** Dimensions of opportunity cost.

Dimension	Consideration	Reference
Extent to which an entrepreneur has choices	The cost incurred versus alternative choices, specific to the individual, where the lower the cost, the more likely to pursue entrepreneurship	[17][47][1]
Full-time versus part-time	Part-time or hybrid entrepreneurship can reduce financial uncertainty	[2][3][48]
Level of human capital	Individuals with greater human capital incur a greater opportunity cost	[5][18][1]
Employment and education history	Work experience and high education levels may promote successful entrepreneurship	[20][18][3][49]
Liquidity and economic risk	Entrepreneurs incur financial costs in terms of income foregone in financing the business and risk in guaranteeing debts and loans	[1][8][19][50]

## 2. Market Assessment

In order to achieve even a modicum of success, entrepreneurs must determine if there is an identifiable market for the opportunity they wish to exploit through some process of market evaluation or assessment [6][51]. Intending entrepreneurs need to make decisions based on identified customer needs rather than unconfirmed assumptions [52][29][53] and this includes considering revenue and cost drivers as well as assessing potential competition [5]. In fact, competition is particularly pertinent where an entrepreneur is employing a first-mover strategy [54], and so while market-related decisions can be some of the most profound organizational decisions an entrepreneur will face, they can also be overwhelming for an aspiring entrepreneur [10].

Much of the research in the area of market assessment and quantitative work on target markets stems from the areas of economics and econometrics. The focus of this research has largely been on estimating strategies for the mode of market entry for new opportunities [55][56]. This becomes challenging and costly, particularly for firms with limited managerial capacity and other resource constraints [57]. Beginning by gathering information for assessment [9][61][58] a secondary but equally vital demand is to rally the resources required to enter their preferred market(s), set up their operations, advertise their presence, promote their products, and establish distribution channels, and compounding these demands is uncertainty—around customers preferences, product mix, and pricing and the marketing strategies [3]. As a process, evaluation often begins with an informal investigation of a potential market need, which may precipitate further, more formal reviews [15] which traditionally take the form of feasibility analysis, market research or market experimentation [9][53]. However, the dilemma for the entrepreneur is about where to stop the evaluation and begin to exploit the opportunity and enter the market to recoup such early resource spending [5][59].

In addressing this issue, Choi et al. [9] theorize that there exists a trade-off between the time needed to increase legitimacy and the requirement to act. Conceiving a concept described as an “ignorance threshold”, they posit that once an entrepreneur reaches a threshold of accumulated knowledge then they should move to the next stage of exploitation action. In turn, there are several factors that influence this. For example, serial entrepreneurs tend to identify more potential markets before moving on [60][61] and consistent with the human capital discussion in the previous section of this paper, individuals with prior industry experience may already have prior market knowledge [20][62]. Clearly, this may represent an advantage over entrepreneurs who have no such experience, although such consideration needs to be balanced against the common entrepreneurial cognitive biases such as overconfidence and excessive risk-taking propensity [63]. Equally, while expert entrepreneurs often apply both predictive and non-predictive logic in evaluating a market opportunity [60], there also exists the possibility that their experience may be irrelevant, thereby rendering it ineffective in arriving at the ignorance threshold.

Market evaluation is essentially about addressing a customer problem and building value around a defined need rather than creating a novel but perhaps unnecessary or superfluous idea [10]. This not only has the effect of improving decision-making but also improves credibility in the eyes of potential stakeholders and financiers. Specifically, in the context of nascent entrepreneurship, one of the most critical aspects of this process is in the assessment of competitive forces. Timing is crucial [9] because the longer that is spent on evaluation, the greater the chance given to competitors to assimilate information on the new venture and thus become better prepared to compete against it—a factor that becomes more critical as the opportunities are novel. In this light, the dimensions of the construct are shown in **Table 2**. These dimensions are used to guide the development of our data collection instrument.

**Table 2.** Dimensions of market evaluation.

Dimension	Consideration	Reference
Evaluation of an opportunity	Begins with an informal market investigation, becoming more formal as the likelihood of exploitation increases	[9][10][15][64][65]
	The more defensible a market position, the more attractive the opportunity	
Evaluation of market opportunities	Identifying more potential markets to provide a choice of the market to pursue	[60][10]
Evaluation of customer value	Must be market-orientated to create superior customer value	[52][65][66][67]
Evaluation of competition	At a threshold, need to cease evaluation and action the exploitation in order to gain a first-mover advantage before the competition learns to compete	[9][29][64]
Evaluation of exploitation decision	Exploitation is more likely when the entrepreneur perceives more knowledge of customer demand for the opportunity	[52][9][17]

### 3. Financial Analysis

People enter the entrepreneurial fray for a variety of reasons and financial considerations are of central import, whether they represent the primary motivation or not. Consistent with the opportunity cost arguments, Shane and Venkataraman [17] found that exploiting opportunities is more common when people have access to financial capital, and Shane [68] provides empirical evidence that in addition to radicalness and patent scope, the commercialization of inventions and innovations is heavily influenced by the magnitude of their economic value. However, this is not a static concept, and so in considering financial analysis in the context of opportunity evaluation, this must take two forms—current state analysis

and future state predictions. The former refers to the examination and review of accounting statements measuring what is actually happening in the new business and the latter to projections and predictions of sales and other indicators. In turn, this means that the frequency with which a firm prepares such statements determines the minimum interval for performing such evaluations [69]. The resulting conundrum results from the fact that the stability and consequently the ability to estimate such figures may be problematic in a fledgling firm, raising additional questions about whether to abandon further opportunity evaluation and instead exploit the business opportunity to drive a potential income stream and promote its own survival [9][29][64].

What is not the subject of debate, however, is the fact that undercapitalization and cash-flow problems are some of the main reasons for venture failure, especially in technology-oriented ventures [70][71]. Therefore, acquiring the confidence of potential investors is critical and can be achieved by reliable predictions about future firm performance and viability [69][6][71]. Research has shown that nascent entrepreneurs who devoted time to preparing financial projections were substantially more likely to attract investment [18] and not just from external sources [50][71]. However, uncertainty presents a challenge in the early stages of the process [69][18][71] and may lead to optimistic prediction error [72].

Despite these recognized difficulties, nearly all research dealing with the acquisition of financial capital concerning entrepreneurship concerns itself with the firm rather than the venture [73][71][72][74][75]. This means that such studies are based around legal constructions of the firm rather than the more general exploitable opportunity stage of venture creation and notwithstanding the fact that some studies have captured their samples at the time that firms were born, the literature provides an incomplete picture of the exploration phase in the entrepreneurial process, suggesting an imperative for including it in this and future research—the dimensions of which are summarized in **Table 3**. They are used to inform the development of our data collection instrument for our fieldwork.

**Table 3.** Dimensions of financial analysis.

Dimension	Consideration	Reference
Evaluation of current financial position and performance	Financial statements are a communication tool for investors where the frequency of preparation reflects minimum evaluation interval	[69][52][5][6][18]
Evaluation of an opportunity	Focus is on opportunities with the ability to generate positive cash flow	[17][5][30]
Evaluation of market opportunities	Entrepreneurs only invest what they can afford to lose	[52][60][7]
New business evaluation/financial projections	Industry experience is associated with more accurate forecasts	[20][8]
Importance of finance	Financial resources are critical to early new venture development	[69][6][18]
Importance of previous experience	Higher levels of education and net worth associated with a greater likelihood of external funding	[50][76]

## 4. Concluding Remarks

Prior work suggests that entrepreneurs have little difficulty generating a large number of ideas for potential businesses; however, their key challenge is in the effective evaluation of those ideas. We argue that the evaluation of opportunities is perhaps the most critical element in the early entrepreneurial process because it describes the entrepreneur's assessment of whether his or her idea can generate the requisite returns for the resources available. This is particularly important for technology entrepreneurs as investments are often high, lead times from development to market are long and the risk of failure is high. The outcome of the evaluation process ultimately determines whether and how the opportunity will be exploited, and thus whether the new enterprise will succeed or fail. A synthesis of the literature reveals that the opportunity cost of a new business and how market and financial information influence the direction of a new business are particularly important to entrepreneurs.

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