

New Venture Ideas and Entrepreneurial Opportunities: Understanding the Process of Opportunity Recognition

Robert P. Singh (STUDENT), University of Illinois at Chicago
Institute for Entrepreneurial Studies (M/C 244)
College of Business Administration
601 South Morgan Street, Suite 809
Chicago, IL 60607
office phone: 847-910-3885
home phone: 847-864-1550
email: rsingh2@uic.edu

Gerald E. Hills, University of Illinois at Chicago
Institute for Entrepreneurial Studies (M/C 244)
College of Business Administration
601 South Morgan Street, Suite 809
Chicago, IL 60607
office phone: 312-996-9130
home phone: 847-864-9257
email: gehills@uic.edu

G. T. Lumpkin, University of Illinois at Chicago
Institute for Entrepreneurial Studies (M/C 244)
College of Business Administration
601 South Morgan Street, Suite 809
Chicago, IL 60607
office phone: 312-996-8285
home phone: 630-293-3054
email: tlumpkin@uic.edu

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Abstract

The process of opportunity recognition is critical to entrepreneurship. In order to better understand the steps in the process, this paper distinguishes new venture ideas from entrepreneurial opportunities and discusses the important role played by entrepreneurs' social networks in the recognition process. Empirical results based on 303 responses received by mail survey of entrepreneurs in information technology consulting firms reveal clear differences between ideas and opportunities and further, that social networks are important at both the idea identification and opportunity recognition stages of the process. Implications for academic research, entrepreneurship education, and business practice are discussed.

Introduction

The fundamental activity of entrepreneurship is new venture creation (Gartner, 1985, 1990). A major step in any entrepreneurial venture creation process is the *recognition of the opportunity* by the entrepreneur (e.g., Hills, 1995; Timmons, Muzyka, Stevenson, & Bygrave, 1987). Based primarily on the definition offered by Christensen, Madsen, and Peterson (1989), we define opportunity recognition as perceiving a possibility for new profit potential through (a) the founding and formation of a new venture, or b) the significant improvement of an existing venture. From this broad definition, opportunity recognition can be conceived of as an activity that can occur both prior to firm founding and after firm founding throughout the life of the firm. Yet, little is known about how entrepreneurs identify opportunities (Hills, 1995).

An idea for an entrepreneurial business does not necessarily equate to an opportunity - although it is always at the heart of an opportunity (Timmons, 1990, 1994a, 1994b; Bygrave, 1994). Entrepreneurship is a market driven process (Hills, 1994), and as Timmons (1990) points out, "building a better mousetrap" will not necessarily mean that people will want to buy the new trap. Other factors must exist to support the new product idea for it to become an opportunity as potential customers must *want* the product. Hence, we can think of the "idea" as a stepping stone that leads to an opportunity. Opportunity recognition is therefore a *process* rather than a one-time "eureka" experience.

One particularly important source of new venture ideas and entrepreneurial opportunities may be entrepreneurs' social networks (Hills, Lumpkin, & Singh, 1997). Social networks encompass all of the people an individual knows -- family members, friends, business associates. Johannisson (1990; p. 41) describes entrepreneurs' personal networks as the "most significant resource of the firm." Individuals are limited in their ability to process and store information which results in bounded rationality (Simon, 1976). People within an entrepreneur's social network can help expand the boundaries of this rationality by expanding the knowledge and information levels of entrepreneurs, which can lead to the identification of more ideas and the recognition of more opportunities.

This paper explores the opportunity recognition process by focusing on differences between new venture ideas and entrepreneurial opportunities. In addition, we studied the role of personal contacts within entrepreneurs' social networks in the recognition process. We develop a conceptual discussion of entrepreneurial opportunities and provide empirical results based on mail survey responses from 303 entrepreneurs which detail the differences between ideas and opportunities. Further, we provide a discussion of elements of opportunity recognition which surround both new venture idea identification and entrepreneurial opportunity recognition and discuss the implications of these findings for academic research, entrepreneurship education, and business practice.

The Opportunity Recognition Process

Prior theory development and empirical research has addressed various aspects of the opportunity recognition process. In a comparative study, Hills (1996) compared the responses of a group of highly successful entrepreneurs (n=53) to a representative sample of entrepreneurs (n=187) on a variety of opportunity recognition items. Over 85 percent of both groups indicated that identifying opportunities was really several learning steps over time, rather than a one-time occurrence. Conventional academic thought has been that systematic search and/or careful strategic planning is a recommended path for identifying entrepreneurial opportunities (Timmons, Muzyka, Stevenson, & Bygrave, 1987). However, Hills (1996) also found that formal customer surveys and market analyses were not considered as important as "gut feel" to entrepreneurs when it came to evaluating opportunities. These results seem to indicate that personal insights and intuitive processes are as important for identifying opportunities as systematic search or planning.

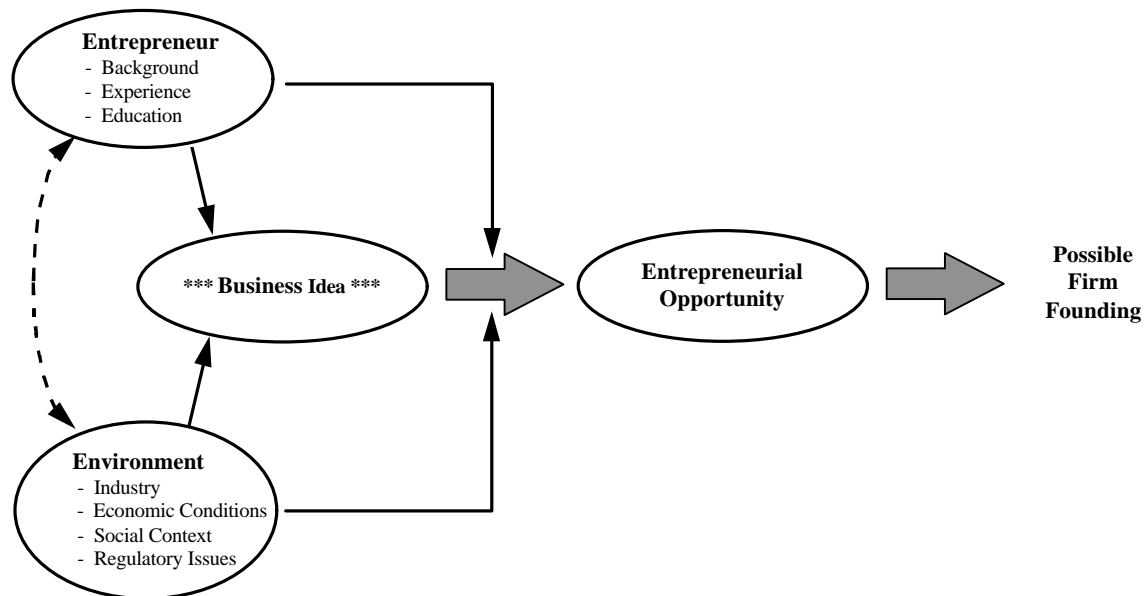
From a social network perspective, personal contacts within an entrepreneur's network are critical for new venture idea identification and opportunity recognition. Christensen and Peterson (1990) concluded that, in addition to profound market or technological knowledge, specific problems and social encounters are often a source of venture ideas. Similarly, both Koller (1988) and Hills, et al. (1997) reported that about 50 percent of entrepreneurs identified the ideas for their businesses through other people in their social networks.

Long and McMullan (1984) describe the opportunity recognition process as being at least partially under the control of the entrepreneur. They suggest that in order to realize the potential of an opportunity, a significant amount of preparation is required. And it is this preparation that "personalizes" the opportunity, making it generally inaccessible to most other people. According to their model, a confluence of factors, including both uncontrolled factors (cultural, social, economic and job forces, and personality) and controlled factors (alertness, job selection, study, moonlight venturing, and lifestyle), affect the ability of a potential entrepreneur to recognize the opportunity. Through these factors, an individual can have what Long and McMullan (1984) call an 'aha' experience when the opportunity is recognized. Afterwards, the opportunity is elaborated and evaluated before deciding whether or not to proceed. During this "strategic elaboration stage," the opportunity may be honed and modified to better fit the market and to maximize the profit potential.

Timmons' (1994b) proposed a model of successful venture creation based on the three crucial driving forces of entrepreneurship: (1) the founders (entrepreneurs), (2) the resources needed to found

the firm, and (3) the recognition of the opportunity. Surrounding the process are such things as risk, chaos, information asymmetries, resource scarcity, uncertainty, paradoxes, and confusion, all of which complicate the process. Only when all three components converge and *fit* can entrepreneurship occur successfully. The challenge for the entrepreneur is to manipulate and influence the surrounding factors in *real time* to improve the chances for success of a venture. As Timmons (1994b) notes, time does not stand still and the process of recognizing and seizing an opportunity often relies on the right timing. Thus, according to Timmons (1990, 1994a, 1994b), the business idea is central to opportunity. However, only when the business environment and the skills and backgrounds of individual entrepreneurs fit together appropriately with the features of an opportunity can it reach its full potential. Based on the combination of Timmons' discussion and the Long and McMullan (1984) model, therefore, Figure 1 illustrates our conceptual model of the entrepreneurial opportunity.

Figure 1
The Entrepreneurial Opportunity



In Figure 1, an entrepreneur's personal characteristics and environment influence the process of proceeding from a new venture idea to an entrepreneurial opportunity. An important issue with respect to the model is timing; more specifically, when does the idea become an opportunity, and how long after the recognition of the entrepreneurial opportunity are resources acquired and the firm founded? In this paper we test the general validity of this model and examine issues related to steps in the model.

Research Method

All data for this study were collected using a six page questionnaire. The sampling frame for the study was obtained from Dun & Bradstreet (D&B). Questionnaires were mailed to 1,402 entrepreneurs who had founded information technology consulting firms (SIC code 7379-02) in 1994 or later. Following two mailings, separated by a postcard reminder, a total of 308 surveys

were returned for an overall response rate of 22 percent. This compares favorably with other recent, published papers in the entrepreneurship literature which utilized mail surveys to collect data (e.g., Chaganti & Parasuraman, 1996 [12.3%]; Karagozolu & Lindell, 1998 [23%]).

For purposes of analysis, two respondents who did not provide key responses to the survey were deleted. Since the independence, risks, and actions taken by those who launch new ventures may differ from franchisees, we removed three franchisees. The remaining 303 respondents were considered “entrepreneurs” for this study. We tested whether there was a difference between respondents and nonrespondents using *t*-tests between mean annual revenues and mean number of employees. There were no significant differences between the two groups.

In order to frame the difference between ideas and opportunities, sample entrepreneurs were provided with the model and verbal description illustrated in Figure 2. Immediately following the model, three validity check questions were asked to verify whether the respondents understood and agreed with the model. The questions and survey responses are summarized in Table 1.

Figure 2

Basic Steps of the Opportunity Recognition Process

Please keep the following in mind as you consider *ideas* and *opportunities*.



Some people come up with initial new venture ideas. After some additional thought and/or evaluation, they may recognize that their ideas are potential new venture opportunities. With even further thought and consideration one may then decide to start a new venture.

Based on the responses to the validity check questions, entrepreneurs clearly understood and agreed with the model. Table 1 shows that 96 percent of respondents answered the first question on “idea” correctly and 95 percent answered the second question on “opportunity” correctly. There was also strong support for the validity of the model as more than 86 percent agreed with the model. Less than eight percent of the respondents actually disagreed with the model; however another 23 answered that they were not sure of the steps in the model or they incorrectly answered one of the first two validity check questions on the differences between ideas and opportunities. For purposes of analysis, these 47 entrepreneurs were removed because we could not assume that they distinguished between ideas and opportunities, and the measurement items demanded that respondents understand the distinction. Future research should study how these entrepreneurs might view ideas and opportunities differently. The final respondent sample of entrepreneurs used in this study was 256, which represented an 18.3 percent useable response

rate (84.5 percent of the mail survey respondents). The mean annual firm revenues and number of employees were \$1,150,145 and 10.8, respectively. Respondents represented 41 states and the District of Columbia. Approximately 14 percent had immigrated to the United States. The average age of the sample entrepreneurs was 38.7 years and they reported an average of 9.8 years of prior work experience in their industry before founding their firms.

Table 1
Respondent Responses to Validity Check Questions

QUESTION WORDING	RESULTS
A. When someone first thinks of a possible new venture, but Has not evaluated it much at all, this survey would call it a “new venture _____.”	96.0% - Idea 1.0% - Opportunity 3.0% - Not clearly either of these
B. When someone has given a possible new venture some Additional though and/or evaluation, this survey would say That it may lead to a “new venture _____.”	2.0% - Idea 95.0% - Opportunity 3.0% - Not clearly either of these
C. Do you agree that the steps in the model illustrated above <i>Generally</i> occur as shown?	86.1% - Yes 7.9% - No 5.9% - Not Sure

Results

Numbers of Ideas and Opportunities Recognized

Table 2 summarizes the results of self reported numbers of new venture ideas identified and opportunities recognized. We found that entrepreneurs identified twice as many ideas as opportunities, which supports the proposition that not all ideas are opportunities.

Table 2
Mean Numbers of Ideas and Opportunities Recognized

ITEM	MEAN	ST. DEV.
Ideas last month	2.4	2.3
Ideas last year	6.6	4.1
Opportunities last month	1.2	1.5
Opportunities last year	3.3	3.1

n=253 (3 respondents did not fill these questions out)

Sources of Ideas

Entrepreneurs were asked to provide the sources of the initial new venture idea for their business. Table 3 presents the reported idea sources.

Table 3
Where Entrepreneurs Get Their New Venture Ideas

SOURCE	PERCENTAGE OF RESPONDENTS
Prior Experience	73.0%
Business Associates	32.8%
Saw a Similar Business	25.8%
Friends or Relatives	19.1%
Hobby/Personal Interest	17.2%
Market Research	11.3%
It Just Came to Mind	10.9%
Magazine/Newspaper	2.3%
Radio/Television	0.4%
Other	4.7%

n=256

Note: Entrepreneurs could indicate more than one source.

Prior experience was by far the most important source of new venture ideas that led to the founding of firms (73 percent). This is consistent with the finding that the entrepreneurs in this study had an average of almost 10 years of industry experience prior to starting their business. However, social network contacts were also clearly important to idea identification. Following prior experience, a large percentage of entrepreneurs identified business associates (32.8 percent) and friends and family (19.1 percent) as the source of the ideas for their business.

A substantial percentage also reported that they saw a similar business (25.8 percent) as the source of their new venture idea. Most of those who reported that they had seen a similar business also based their venture ideas on prior experience (66.7 percent of those who reported seeing a similar business). This further indicates that many entrepreneurs model their firms on companies in which they worked; that is, after working for information technology firms, they realized that they could provide the same services to clients themselves.

A closer analysis of the social network sources found that approximately 42 percent indicated that they had obtained the idea for their business from business associates, friends, or family. This result is consistent with the findings of two other empirical studies which studied social network information sources for new venture ideas (Hills, Lumpkin, & Singh, 1997; Koller, 1988). In addition, the responses revealed that of those entrepreneurs who reported obtaining the idea from business associates, more than 72 percent also indicated that the idea was based on prior experience. Thus, working in an industry provides access to professionals within the industry that can help entrepreneurs identify new venture ideas within that industry.

Turning Ideas into Opportunities

As discussed earlier regarding the research model (Figure 2) and the model of entrepreneurial opportunity (Figure 1), entrepreneurs usually take some action or conduct further evaluations to turn ideas into opportunities. Table 4 presents the activities that were performed by the respondents.

Table 4 presents clear evidence of the importance of social networks to opportunity recognition. The results show that entrepreneurs discussed their new venture ideas with potential clients/customers (50 percent), friends and family (46.5 percent), and/or sought out information/feedback from business associates (52 percent). In fact, 75 percent of the respondent entrepreneurs cited at least one of the above social network activities as part of their opportunity recognition process.

A potentially interesting subgroup of entrepreneurs is the one that “just knew the idea was an opportunity” (33.2 percent). These individuals did not have significantly different levels of prior experience than other entrepreneurs, nor did they have more successful firms. They may represent individuals who are highly alert to opportunities, who are more apt to trust their “gut feel,” or perhaps be those who have higher levels of self-efficacy. Also, given the number of years of prior industry experience, a formal evaluation process may not be required by all entrepreneurs. Further research is needed on this subgroup.

Table 4
Opportunity Recognition Activities: How Entrepreneurs Turned Ideas Into Opportunities

ACTIVITY	PERCENTAGE OF RESPONDENTS
Sought out information/feedback from business associates	52.0%
Contacted potential customers/clients	50.0%
Discussed idea with friends/family members	46.5%
Gathered information on competitors	33.6%
None, just knew idea was an opportunity	33.2%
Prepared financial statements	25.0%
Other	3.5%

n=256

Note: Entrepreneurs could indicate more than one source.

Time Between Initial Idea and Opportunity Recognition

Entrepreneurs were asked to identify the approximate time, if any, that elapsed between when they first identified the idea for their firm and when they recognized the opportunity for their firm. Respondents were able to distinguish the duration of time between the two events and, interestingly, there was a wide distribution of times reported. Table 5 summarizes the results.

Table 5
Time Between New Venture Idea Identification and Entrepreneurial Opportunity Recognition

TIME	PERCENTAGE OF ENTREPRENEURS
None	13.7%
Hours	2.3%
Days	14.5%
Weeks	22.7%
Months	35.9%
Years	10.9%

n=256

For most entrepreneurs, a substantial amount of time passed before the *idea* for their business became the *opportunity* for their business. More than 45 percent of the entrepreneurs described the length of time to be months or even years. For about 37 percent of the entrepreneurs, their ideas were recognized as opportunities within a matter of days or weeks. Only 16 percent of entrepreneurs recognized opportunities from their ideas in little or no time.

While most entrepreneurs took an extended period of time before recognizing their new venture idea as an opportunity for a business, the third group described above took virtually no time. We tested to see if there was a difference in the amount of prior experience between the third group and all other entrepreneurs. It may have been that those individuals with more experience did not need to take any time to consider whether an opportunity existed -- they would know because they had the personal background to understand that their idea was an opportunity. However, further analysis of those entrepreneurs revealed that they did not have significantly more prior experience than the other two groups of entrepreneurs.

Time Between Opportunity Recognition and Firm Founding

As presented in the research model, after an opportunity was recognized, a period of time usually elapsed before the entrepreneur founded his/her firm. As with the timing between idea generation and opportunity recognition, most entrepreneurs (61 percent) took months or years to start their firm (see Table 6). Less than 13 percent of the entrepreneurs reported only taking hours or days, while 26.2 percent reported taking weeks. This, combined with the results in Table 5, demonstrate that entrepreneurs in this sample took time proceeding through the process before starting a business. Most entrepreneurs take months and even years from the time they first realize their initial venture idea to when they found their firm. This begs the question of what happens within that extended time frame. Some research has attempted to examine pre-organization activities in the early stages of the entrepreneurship process (e.g., Bird, 1992, Learned, 1992), but as yet, no one has empirically tested models which separate idea identification and opportunity recognition. Based on the findings reported in this study, further elaboration of pre-organization process models and opportunity recognition models is needed.

Table 6
Time Between Opportunity Recognition And Firm Founding

TIME	PERCENTAGE OF ENTREPRENEURS
Hours	1.6%
Days	11.3%
Weeks	26.2%
Months	50.8%
Years	10.2%

n=256

Modifications to the Initial New Venture Idea

During the time before opportunity recognition, it is likely that the initial idea or conception of the business is modified as the opportunity is shaped. In order to test whether any modification took place, entrepreneurs were asked to report the extent of change that occurred in their venture ideas before they were recognized as opportunities. Table 7 summarizes the results.

Table 7
Amount of Modification to New Venture Idea
Before it Became a New Venture Opportunity

CHANGE	PERCENTAGE OF ENTREPRENEURS
No Change	19.1%
Slight Change	42.6%
Moderate Change	28.5%
Major Change	9.0%
Complete Change	0.8%

n=256

As shown in Table 7, most entrepreneurs did make some change to their initial venture idea before it became an opportunity. For many it was a slight change (42.6 percent); however, 28.5 percent reported making a moderate change and nearly 10 percent made a major or complete change in their business idea. The fact that entrepreneurs had years of experience in their industry prior to founding probably minimized the changes. But, even with an average of 10 years of personal experience, more than one-third of the entrepreneurs made a moderate, major, or complete change to their business idea. Further, given that 75 percent of the sample reported discussing their new venture idea with social network contacts in order to recognize the opportunity for their firm, there is support for the thesis that social networks help to modify ideas so that they may be recognized as opportunities.

Implications

The process of identifying fledgling ideas and then developing them into bona fide business opportunities is a key element of the new venture creation process. This paper has explored several aspects of this important pre-startup activity. Overall, the findings support the notion that ideas and opportunities are distinct constructs and that different activities take place at different times within the opportunity recognition process. Yet there also appears to be a minority of entrepreneurs deserving of further research who did not distinguish ideas and opportunities. There is also evidence that the processes of opportunity recognition and firm founding can be

extended, and that an entrepreneur's social network can play a vital role in the recognition process. These findings have important implications for academic research, entrepreneurship education, and business practice.

Academic Research

When studying opportunity recognition, researchers should carefully frame ideas and opportunities for their study sample. We have developed a parsimonious research model that has been shown to have external validity. The model can be an important tool in the study of opportunity recognition because it offers a theoretical framework that can easily be understood by survey subjects or interviewees. It can be presented to a study subject quickly and easily before opportunity recognition questions are presented. Such an approach may help build consensus among entrepreneurship scholars regarding the nature of the opportunity recognition process, since, as noted above, the definition of opportunities has not been consistent in published research and, as such, it is difficult to compare across studies. Using this model, the researcher can validate that research subjects perceive the difference between ideas and opportunities.

We suggest that future studies acknowledge this distinction and further explore the time dimension and activities between an initial idea and its development into a new venture founding. Alternatively, theorists who disagree with the model proposed in this paper might endeavor to empirically test other explanations for the relationship between ideas and opportunities. In either case, advanced research methods are needed; specifically, more fine grained studies and ideally longitudinal studies that collect both quantitative and qualitative data from different industries. We need to seek a better understanding of the specific activities that occur and the relative importance of each activity.

Entrepreneurship Education

Courses in entrepreneurship typically focus on writing business plans and obtaining financing. Opportunity recognition represents a critically important pre-founding activity that needs to be integrated into the curriculum of entrepreneurial education. Although some entrepreneurship texts include sections on opportunity recognition, (e.g., Allen, 1995), few go as far as Timmons, 1994a) who talks extensively about the importance and nature of the opportunity recognition process. As noted above, his discussion regarding the differences between ideas and opportunities, and his description of the characteristics of an opportunity and the environmental conditions that favor new opportunities, were useful in formulating this study. Entrepreneurship educators, therefore, could broaden the scope of their material and potentially strengthen course offerings by integrating opportunity recognition concepts into entrepreneurship curricula.

Business Practice

For entrepreneurs and those interested in more effectively identifying opportunities, the findings of this study strongly suggest that social networks are critical during the opportunity recognition process. Using social network contacts in the opportunity recognition process may be one way to help reduce the liability of newness (Stinchcombe, 1965). By actively engaging in exchange

behaviors with relevant social contacts (potential clients, friends, business contacts, family members), entrepreneurs may be better equipped to obtain resources such as financial backing, psychological support, physical goods, and business information to facilitate their ventures' survival (Hansen & Allen, 1992). This may be critical because new enterprises often lack the experience and resources needed to develop a resistance to the liability of newness, and further, to establish competitive ability through internal structural adaptation (Lawrence & Lorsch, 1967). Organizations depend on resource exchange in their environment for survival and goal achievement; however, new ventures usually lack the more refined abilities of acquiring resources and information processing functions necessary for growth and survival that established firms have developed. Clearly, if an entrepreneur discusses a business idea with his social contacts and then recognizes the idea as an opportunity, the entrepreneur has gained insight into the quality of the opportunity by virtue of the input and knowledge of others.

Future research can enhance our understanding of the social network-opportunity recognition relationship by asking entrepreneurs and other practitioners how their social contacts affected their pre-startup activities. For example, for those entrepreneurs who indicated that they discussed their new venture ideas with both friends/family and business associates, what were the differences in the discussion content between the two types of social contacts. Did one type provide more useful information than another type? How does an entrepreneur's social network influence what appears to be a substantial time period between the idea identification and firm founding? Future research should also study those firms that fail in order to test if there is a difference in the use of social network contacts during the opportunity recognition process. Thus, more focused study of the role of social contacts during the pre-founding activities may be useful for further understanding of the opportunity recognition process.

Conclusions

Opportunity recognition is a vital feature of the new venture creation process. This paper has explored several aspects of the opportunity recognition process, including the proposition that ideas differ from opportunities and that an entrepreneur's social network contributes to the recognition process. Findings from a survey of 256 information technology consulting founders examine sources of ideas and opportunities and reveal important differences, including the time lag between conceiving of an idea and recognizing it as a bona fide opportunity. The research also indicates that an entrepreneur's social network and prior experience enhance his/her ability to recognize opportunities. Implications of this paper to academics, entrepreneurship educators, and business practitioners were discussed, and fruitful areas for future research have been outlined.

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