Chapter 5: The Challenges of Starting a Business.
5.1 What is an Entrepreneur?

- An **entrepreneur** is someone who identifies a business opportunity and assumes the risk of creating and running a business to take advantage of it.

- There are three characteristics of entrepreneurial activity:
  - **Innovating.** An entrepreneur offers a new product, applies a new technique or technology, opens a new market, or develops a new form of organization for the purpose of producing or enhancing a product.
  - **Running a business.** Entrepreneurship means setting up a business to make a profit from an innovative product or process.
  - **Risk taking.** Risk means that an outcome is unknown. Entrepreneurs, therefore, are always working under a certain degree of uncertainty, and they can’t know the outcomes of many of the decisions that they have to make.
5.1 What is an Entrepreneur?

- According to the SBA, a government agency that provides assistance to small businesses, there are five advantages to starting a business—“for the right person”:

1. Be your own boss.
2. Accommodate a desired lifestyle.
3. Achieve financial independence.
4. Enjoy creative freedom.
5. Use your skills and knowledge.
5.1 What is an Entrepreneur?

- To determine whether you’re one of the “right people” to exploit the advantages of starting your own business, the SBA suggests that you assess your strengths and weaknesses by asking yourself the following questions:

1. Am I a self-starter?
2. How well do I get along with different personalities?
3. How good am I at making decisions?
4. Do I have the physical and emotional stamina?
5. How well do I plan and organize?
6. Is my drive strong enough?
7. How will my business affect my family?
5.1 What is an Entrepreneur?

• Though most entrepreneurial ventures begin as small businesses, not all small business owners are entrepreneurs. Entrepreneurs are innovators who start companies to create new or improved products. In contrast, many people start businesses for the purpose of providing an income for themselves and their families. This type of businesses is sometimes called a “lifestyle business.”
5.2 The importance of small business in the US economy.

- According to the SBA, a small business is independently owned and operated, exerts little influence in its industry, and (with minimal exceptions) has fewer than five hundred employees.

- The nearly twenty-seven million small businesses in the United States generate about 50 percent of our GDP. They also contribute to growth and vitality in several important areas of economic and socioeconomic development. In particular, small businesses do the following:
  - Create jobs
  - Spark innovation
  - Provide opportunities for women and minorities to achieve financial success and independence
5.2 The importance of small business in the US economy.

Figure 5.2 Businesses Owned by Women and Minorities
5.2 The importance of small business in the US economy.

- Small businesses tend to foster environments that appeal to individuals with the talent to invent new products or improve the way things are done. They typically make faster decisions, their research programs often are focused, and their compensation structures frequently reward top performers.

- Small firms supply many of the components needed by big companies. They also provide large firms with such services as accounting, legal, and insurance, and many provide *outsourcing* services to large companies—that is, they hire themselves out to help with special projects or handle certain business functions. Small companies (such as automotive dealerships) often act as sales agents for the products of large businesses (for example, car makers).
5.3 What industries are small business in?

- An *industry* is a group of companies that compete with one another to sell similar products. There are two broad types of industries, or *sectors*:

  - The *goods-producing sector* includes all businesses that produce tangible goods.

  - The *service-producing sector* includes all businesses that provide services but don’t make tangible goods.
5.3 What industries are small business in?

Figure 5.5 Small Business by Industry

- Construction 13%
- Professional, scientific, technical services 14%
- Retail and wholesale trade 12%
- Real estate, rental and leasing 10%
- Health care and social assistance 9%
- Administrative, waste management, remediation 8%
- Transportation, warehousing 5%
- Arts, entertainment and recreation 5%
- Manufacturing, agriculture, mining 4%
- Other services, including accommodations and food services 16%
- Finance and insurance 4%
5.3 What industries are small business in?

- The largest areas of the goods-producing sector are construction and manufacturing. Construction businesses are often started by skilled workers, such as electricians, painters, plumbers, and home builders. These businesses tend to be small and generally focused on local projects. Though manufacturing is primarily the domain of large businesses, there are exceptions.

- Many small businesses in the service-producing sector are retailers—they buy goods from other firms and resell them to consumers, in stores, by phone, through direct mailings, or over the Internet. Other small business owners in this sector are wholesalers—they sell products to businesses that buy them for resale or for company use. A high proportion of small businesses in this sector provide professional, business, or personal services.
There are several advantages that, generally speaking, come with success in business ownership:

- **Independence.** As a business owner, you’re your own boss.

- **Lifestyle.** Because you’re in charge, you decide when and where you want to work.

- **Financial rewards.** In spite of high financial risk, running your own business gives you a chance to make more money than if you were employed by someone else.

- **Learning opportunities.** As a business owner, you’ll be involved in all aspects of your business.

- **Creative freedom and personal satisfaction.** As a business owner, you’ll be able to work in a field that you really enjoy, and you’ll gain personal satisfaction from watching your business succeed.
5.4 Advantages and Disadvantages of Business Ownership

Figure 5.6 The Entrepreneur’s Workweek
5.4 Advantages and Disadvantages of Business Ownership.

• There are also a number of potential disadvantages to consider in deciding whether to start a small business:

• *Financial risk.* The financial resources needed to start and grow a business can be extensive, and if things don’t go well, you may face substantial financial loss. In addition, you’ll have no guaranteed income.

• *Stress.* You’ll have a bewildering array of things to worry about—competition, employees, bills, equipment breakdowns, customer problems.

• *Time commitment.* Running a business is extremely time-consuming. In fact, you’ll probably have less free time than you’d have working for someone else.

• *Undesirable duties.* You’ll be responsible for either doing or overseeing just about everything that needs to be done, and you’ll probably have to perform some unpleasant tasks, like firing people.
Before starting a business, you need to ask yourself a few basic questions:

1. What, exactly, is my *business idea*? Is it feasible?
2. What type of business is right for me? What *industry* do I want to get into?
3. Do I want to run a business that’s similar to many existing businesses, or do I want to innovate?
4. Do I want to start a new business, take over an existing one, or buy a franchise?
5. Do I want to start the business by myself, or do I want company?
6. What form of *business organization* do I want?
5.5 Starting a Business.

Figure 5.8 The Growth of Franchising, 1980–2007

In 1980, franchisers had gross total revenues of $350 billion; by 2007, revenues had increased to nearly $1.3 trillion a year.
After you’ve addressed these basic questions, you’ll be ready to describe your future business in the form of a business plan—a document that identifies the goals of your proposed business and explains how it will achieve them. Before you actually start up your business, you must also get financing.

The key to coming up with a business idea is identifying something that customers want. Your business will probably survive only if its “purpose” is to satisfy its customers—the ultimate users of its goods or services.
You can become a small business owner in one of three ways, each of which has advantages and disadvantages:

1. **Starting from scratch.** This is the most common—and riskiest—option. *Advantage:* You start with a clean slate and build the business the way you want. *Disadvantage:* It’s up to you to develop your customer base and build your reputation.

2. **Buying an existing business.** This option is not as risky as starting a business from scratch, but it has some drawbacks. *Advantages:* You’ll already have a proven product, current customers, active suppliers, a known location, and trained employees. *Disadvantages:* It’s hard to determine how much to pay for a business; perhaps the current owners have disappointed customers; maybe the location isn’t as good as it used to be.

3. **Buying a franchise.** Under a franchise setup, a franchiser (the company that sells the franchise) grants the franchisee (the buyer) the right to use a brand name and to sell its goods or services. *Advantages:* You’ve bought a prepackaged, ready-to-go business that’s proven successful elsewhere; you also get ongoing support from the franchiser. *Disadvantages:* The cost can be high; you have to play by the franchiser’s rules; and franchisers don’t always keep their promises.
5.6 The Business Plan

- A **business plan** tells the story of your business concept, provides an overview of the industry in which you will operate, describes the goods or services you will provide, identifies your customers and proposed marketing activities, explains the qualifications of your management team, and states your projected income and borrowing needs.

- In your business plan, you make strategic decisions in the areas of management, operations, marketing, accounting, and finance. Developing your business plan forces you to analyze your business concept and the industry in which you’ll be operating. Its most common use is persuading investors and lenders to provide financing.
5.6 The Business Plan

- A business plan generally includes the following sections:
  1. **Executive summary.** One- to three-page overview.
  2. **Description of proposed business.** Brief description of the company that answers such questions as what your proposed company will do, what goods or services it will provide, and who its main customers will be.
  3. **Industry analysis.** Short introduction to the industry in which you propose to operate.
  4. **Mission statement and core values.** Declaration of your mission statement, which are fundamental beliefs about what’s important and what is (and isn’t) appropriate in conducting company activities.
  5. **Management plan.** Information about management team qualifications and responsibilities, and designation of your proposed legal form of organization.
  6. **Goods, services, and the production process.** Description of the goods and services that you’ll provide in the marketplace; explanation of how you plan to obtain or make your products or of the process by which you’ll deliver your services.
  7. **Marketing.** Description of your plans in four marketing-related areas: target market, pricing, distribution, and promotion.
  8. **Global issues.** Description of your involvement, if any, in international markets.
  9. **Financial plan.** Report on the cash you’ll need for start-up and initial operations, proposed funding sources, and means of repaying your debt.
  10. **Appendices.** Supplemental information that may be of interest to the reader.
5.7 How to Succeed in Managing a Business.

- Business owners face numerous challenges, and the ability to meet them is a major factor in success (or failure). As a business owner, you should do the following:

  1. **Know your business.** Successful businesspeople are knowledgeable about the industry in which they operate, and they know who their competitors are.
  2. **Know the basics of business management.** To manage a business, you need to understand the functional areas of business—accounting, finance, management, marketing, and production.
  3. **Have the proper attitude.** You should believe in what you’re doing and make a strong personal commitment to it.
  4. **Get adequate funding.** Plan for the long term and work with lenders and investors to ensure that you’ll have sufficient funds to get open, stay open during the start-up phase, and, ultimately, expand.
  5. **Manage your money effectively.** You need to pay attention to cash flow—money coming in and money going out—and you need to know how to gather the financial information that you require to run your business.
  6. **Manage your time efficiently.** You must develop time-management skills and learn how to delegate responsibility.
  7. **Know how to manage people.** You need to develop a positive working relationship with your employees, train them properly, and motivate them to provide quality goods or services.
  8. **Satisfy your customers.** Commit yourself to satisfying—or even exceeding—customer needs.
  9. **Know how to compete.** Find your niche in the marketplace, keep an eye on your competitors, and be prepared to react to changes in your business environment.
5.7 How to Succeed in Managing a Business.

Table 5.2 Survival Rate of New Companies

<table>
<thead>
<tr>
<th>Number of Years after Start-up</th>
<th>Rate of Survival</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>81.2%</td>
</tr>
<tr>
<td>2</td>
<td>65.8%</td>
</tr>
<tr>
<td>3</td>
<td>54.3%</td>
</tr>
<tr>
<td>4</td>
<td>44.4%</td>
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<tr>
<td>5</td>
<td>38.3%</td>
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<tr>
<td>6</td>
<td>34.4%</td>
</tr>
<tr>
<td>7</td>
<td>31.2%</td>
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</tbody>
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Note: Percentages based on a total of 212,182 businesses that started up in the second quarter of 1998.
Businesses fail for any number of reasons, but many experts agree that the vast majority of failures result from some combination of the following problems:

1. **Bad business idea.** Like any idea, a business idea can be flawed, either in the conception or in the execution.
2. **Cash problems.** Too many new businesses are underfunded.
3. **Managerial inexperience or incompetence.** Many new business owners have no experience in running a business, and many have limited management skills.
4. **Lack of customer focus.** Some owners fail to make the most of a small business’s advantage in providing special attention to customers.
5. **Inability to handle growth.** When a company grows, some owners fail to delegate work or to build an organizational structure that can handle increases in volume.
5.7 How to Succeed in Managing a Business.

- Services available to current and prospective small business owners from the SBA include assistance in developing a business plan, starting a business, obtaining financing, and managing an organization.

- The SBDC (Small Business Development Centers) matches businesspeople needing advice with teams of retired executives who work as volunteers through the SCORE program.