

## The role of the entrepreneur

Nigel Watson looks at the risks and rewards of starting a business



Entrepreneurs are individuals who set up new businesses. The first step is the idea: what type of product are they going to try to sell? Most successful entrepreneurs get their ideas for a new business by looking for gaps in the market, such as an unsatisfied consumer want or need, or a discrepancy between what consumers want and what is currently being supplied. According to Akio Morita, the founder of Sony: *'anyone can have an idea; the hard part is to convert that idea into a product..'*

Entrepreneurs don't just talk about their ideas, they act on them to create brandnew businesses. To create new firms,

entrepreneurs need to raise finance to pay start-up costs, such as leasing a building to operate from; buying machinery, equipment and opening stocks of raw materials; and, if necessary, recruiting and training a workforce.

### Risks and rewards

One of the main rewards of being your own boss is financial. Entrepreneurs are not paid wages decided by somebody else. Unlike an employee, entrepreneurs set their own pay by deciding how much profit they wish to withdraw from their businesses. If entrepreneurs want to boost their income, they don't need to negotiate a pay rise from the boss. Instead, they can try to improve their living standards by working harder and longer in order to boost their businesses' profits.

Once their businesses have become established, some entrepreneurs opt to cash in on the success that they have created by selling them to a competitor or investor, thereby hopefully gaining enough money to meet all their future financial needs. This dream of financial security and unlimited leisure time can be sufficient reward to motivate some people into taking the risk of quitting their regular jobs in order to become entrepreneurs.

Starting up a new firm is rarely easy. It requires perseverance, drive and, above all else, courage. Entrepreneurs need to be courageous because success cannot be guaranteed. The personal costs to the entrepreneur of a failed new business can be significant. Banks will usually only lend start-up money if the borrower guarantees the loan with personal property — often the entrepreneur's house, so if the new business fails the entrepreneur stands to lose his or her home. Entrepreneurs are therefore risk takers.

### Opportunity costs

Economists use the term **opportunity cost** to quantify the cost of making a decision in terms of the most valuable thing that had to be given up to make that decision. The potential opportunity costs of a decision to become an entrepreneur include:

#### Lost wages

Prior to setting up their own businesses, most entrepreneurs will have worked for somebody else. To start with, many entrepreneurs will try to run their new businesses alongside their regular jobs. This is called **moonlighting**. Later, once the new business has become established, most entrepreneurs opt to give up their day jobs completely in order to expand their firms. This also means giving up a regular source of income. From a financial perspective, entrepreneurs should compare the wages that they are giving up to the profits that they hope to make from their start-ups.

### Box 1 Kefalonia case study

When the 2008 financial crisis reached the Greek island of Kefalonia, thousands of public sector workers lost their jobs due to government spending cuts. Private sector jobs were also lost because the credit crunch reduced the number of tourists visiting the island. The credit crunch led to the collapse of the Greek housing market, which in turn destroyed the livelihoods of those who relied on property speculation to make a living. On a recent visit to Kefalonia, I noticed a surge in the number of small business start-ups. Untended olive groves have been turned into solar farms. Unemployed Kefalonians have found employment by becoming beekeepers. Others have created jobs for themselves by setting up fish farms or wineries.

#### Lost leisure time

It takes time and commitment to set up a successful new business, which leaves little time left over for leisure activities. According to Phil Libin, the creator of Evernote (a note-taking app designed for tablets and mobiles), being an entrepreneur is:

*'amazingly difficult work — you have no life balance; no family time, and you will never work harder in your life. It really can be brutal.'*

The long working hours required become an entrepreneur can also adversely affect friendships. Shazia Saleem, a serial entrepreneur whose start-ups include a halal food brand called Leat and a redeveloped holiday resort in Cambodia, states that:

*'Everyone tells you it's lonely as an entrepreneur — it's a bit of an understatement. Many times the only person you can turn to for inspiration or comfort is the person staring back at you (often blankly) in the mirror.'*



### **Start-ups on Kefalonia include solar farms and wineries**

#### **Lost interest income**

Many entrepreneurs use their savings to partially fund their business startups. If these savings are ploughed into a new business, the entrepreneur will lose the interest income that they previously received from their savings.

#### **Why become an entrepreneur?**

The most commonly cited reason people give for becoming an entrepreneur is 'I want to be my own boss'. This is unsurprising. According to Professor Fred Herzberg, people are motivated by

the opportunity to use their ability: most of us enjoy the chance to make decisions.

The **theory X style of management**, where workers are expected to just follow the boss' orders, is still dominant in the UK and the USA. According to research published in 2013 by Global Entrepreneurship Monitor, entrepreneurs report far higher levels of job satisfaction than people who work for other people.

Many entrepreneurs enjoy the freedom associated with being their own bosses. Entrepreneurs can set their own working hours — they can choose to work overtime, or to work shorter hours occasionally so that they can attend important family events. Others choose to go it alone because they are sick of being underpaid and feel exploited by their current employers.

In most countries the unemployment rate among immigrants is higher than the national average, because immigrants face racial discrimination in the labour market. Some people become entrepreneurs so that they can escape other people's prejudices, or unemployed immigrants may find work by creating it for themselves. Many of the UK's best-known companies, such as Tesco and Marks and Spencer, were set up by immigrants. According to research published in February 2014 by the Centre for Entrepreneurs, one in seven UK companies was set up by immigrants.



### **Marks and Spencer's co-founder Michael Marks was an immigrant from the Russian empire**

Some people become entrepreneurs by accident. The person concerned may have lost his or her job and need to find an alternative source of income — redundancy payments are often used by budding entrepreneurs to partly fund their start-ups. Many examples of 'accidental' entrepreneurs can be seen on the small Greek island of Kefalonia (Box 1).

#### **Should the government support entrepreneurs?**

Those who favour government intervention argue that the state should help entrepreneurs form new businesses to replace jobs that have moved abroad. The UK government does offer some support for entrepreneurs who want to start new businesses, such as the Start Up Loans scheme, which was established in 2013. Under the scheme, people who want to borrow money to set up a new business must submit a business plan to the government. If the plan is approved, the government makes a loan and charges the entrepreneur an interest rate of 6%, which is well below

the rate of interest that most firms pay. So far £77 million has been lent. This figure looks impressive, but it is actually pitifully small when compared to total UK government spending, which was over £1.5 trillion in 2013. On the other hand, those who believe that the government should not meddle with the economy argue that the government should not give support to entrepreneurs. Can we trust the government to back winners? Can we guarantee that the people appointed to run these schemes will not try to personally profit through payoffs, bribes and other forms of corruption? What about the opportunity costs of these programmes to the taxpayer? In Greece, against all odds, the economy is finally recovering. For the first time since 1948, when records began, Greece is now exporting more than it is importing. This recovery is down to the Greek people themselves, rather than the Greek government. According to Endeavour (an international NGO that provides assistance to entrepreneurs), the number of start-ups in Greece in 2013 was over 80 times higher than in 2010.

### Box 2 KFC case study

Age does not matter when it comes to entrepreneurship. KFC founder Harland Sanders was a late developer as an entrepreneur. However, he was still showing great entrepreneurial energy well into his seventies.

Born in 1890 in Indiana, Sanders disliked school and chose to drop out of education as soon as he could. He was a highly strung individual who was prone to violent outbursts. After a brief spell in the US army he practised law until he had a fight in court with his own client. He then became an insurance salesman, but was dismissed because he refused to follow his boss' instructions.

Sanders sought autonomy, and in 1920 he set up his first business — a ferry service across the Ohio River. Two years later he sold the business on for a substantial profit so that he could raise the funds needed to build a factory that would manufacture acetylene lamps. Unfortunately this new business venture failed and he lost all the money that he had previously made.

During the Great Depression, Sanders reluctantly became an employee again, managing a petrol station in Corbin, Kentucky. To supplement his pay from Standard Oil, Sanders sold hot food to the motorists who visited his service station. The most popular item on his menu was fried chicken — cooked in a pressure cooker, which cooked the meat faster than conventional pan frying. He left Standard Oil in 1939 to establish his own motel, which incorporated the world's first Kentucky Fried Chicken fast food restaurant.

The business was a success, and at the age of 62, when most people are considering retirement, Sanders decided to capitalise on his idea by selling KFC franchises to other entrepreneurs. This was a masterstroke — sales tripled in the first year. KFC also used the franchising model to expand rapidly overseas. At the age of 74 Sanders sold KFC's American restaurants for \$2 million. However, this was not the end of his entrepreneurial exploits — in 1965 he set up a new fried chicken restaurant called 'The Colonel's Lady' with his wife, Claudia Sanders.

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