chapter

4

Entrepreneurship, Small Business, and New Venture Creation

After reading this chapter, you should be able to:

LO-1 Explain the meaning and interrelationship of the terms *small business, new venture creation, and entrepreneurship.*

LO-2 Describe the role of small and new businesses in the Canadian economy.

LO-3 Explain the *entrepreneurial process* and describe its three key elements.

LO-4 Describe three alternative strategies for becoming a business owner—*starting from scratch, buying an existing business, and buying a franchise.*

LO-5 Describe four forms of *legal organization* for a business and discuss the advantages and disadvantages of each.

LO-6 Identify four key reasons for success in small businesses and four key reasons for failure.

*With contributions from Dr. Monica Diochon, St. Francis Xavier University.

Parasuco Jeans: The Story of a Born Entrepreneur

Salvatore Parasuco's company recently celebrated its thirty-fifth year of operation, so his successful denim business is definitely not a new venture, but it is a great tale of entrepreneurship. Words like *drive*, *determination*, *self-starter*, and *vision* are commonly used to describe entrepreneurs. All of these terms fit the founder of Parasuco Jeans to a T. The story begins with a budding entrepreneur whose ambition is announced at a very young age when he begins selling jeans out of his high school locker in Montreal. As legend has it, he managed to convince his principal to let him sell the jeans by telling him he needed to make money to help support his family and avoid going down the wrong path. Today, Parasuco Jeans are sold in locations around the world with distribution in Canada, the United States, Europe, and Asia. The company has a particularly good presence in Italy, Hong Kong, Russia, Japan, and Korea. Celebrities such as Jessica Alba, Kate Hudson, Chris Daughtry, and many more have been photographed wearing a pair of Parasuco's trendy jeans. Yet despite the success and the longevity of the brand it does not have as much visibility across Canada as the owner thinks it deserves. He openly wonders why we Canadians (and the local media in particular) aren't as patriotic toward our homegrown brands as Americans are.

Salvatore is a Canadian whose family came here from Italy when he was just a young boy. From his humble beginnings, he learned the value of a

How Will This Help Me?

Parasuco Jeans has been successful because its entrepreneurial founder has adhered to sound business practices and made effective decisions. By understanding the material discussed in this chapter, you'll be better prepared to (1) understand the challenges and opportunities provided in new venture start-ups, (2) assess the risks and benefits of working in a new business, and (3) evaluate the investment potential inherent in a new business.

© CourseSmart

dollar and credits his father for teaching him the art of negotiation at an early age. The rise of Parasuco Jeans is not a modern-day instant success story with a major internet IPO launch. It is a story about blood, sweat, and some tears. Before getting into the denim design business, Salvatore opened a clothing store, where he learned a lot about the business that would become his life's work. Mr. Parasuco launched Santana Jeans in 1975 and changed the name to Parasuco due to legal issues in 1988. From the early days it was clear that innovation and design would be at the foundation of the company. Parasuco was the first to launch pre-washed jeans in Canada. The company was also the first brand to introduce stretch denim to the market; a product feature that is central to the company image to this day. In a recent interview, the owner talked about how customers tend to instinctively start to stretch and pull his famous jeans. Success in business requires good vision to compete. This is even more complicated in this industry because staying ahead of the fashion trends is no easy task. The guiding mission of the company is based on eight pillars of strength: (1) respect, (2) people, (3) passion, (4) promotion of innovation, (5) performance, (6) pride, (7) pursuit of excellence, and (8) professionalism. Based on a track record that spans over 35 years, it is obvious that this company has done something right in meeting customer needs. But there are significant existing domestic and emerging international competitors; there are even other major brands based in Montreal, such as Buffalo by David Bitton (which has its own niche).

Parasuco Jeans is a brand known for its provocative ads. It has shocked and pushed boundaries for years with sexy billboards, magazine spreads, and bus shelter ads. In order to gain more attention, the company placed 25 ads in giant ice blocks around the city of Toronto to coincide with Fashion Week in 2009, with a tag line to match: "Styles so hot they will melt the ice." Like most fashion companies, Parasuco uses Twitter and Facebook to build buzz and spread the word. There is also a great deal of content on YouTube, which is a testament to the brand's cult-like following.

Even the most successful businesses have their share of disappointments and failures, but true entrepreneurs know how to overcome them, reduce their losses, and to capitalize on the best available opportunity. In 2010, when Parasuco decided to close his flagship New York store, he quickly found a tenant (drugstore chain Duane Reade) that agreed to pay $1 million in rent per year, to Parasuco, who had bought the retail condominium four years earlier for about $9 million dollars. At the same time he announced intentions to build a high-end boutique hotel in Toronto. At 57 years of age, Salvatore Parasuco does not seem to be slowing down one bit; he is visibly promoting his brand and searching for new opportunities. What do you expect? Salvatore Parasuco has the DNA of a pure entrepreneur.

© CourseSmart

Small Business, New Venture Creation, and Entrepreneurship

In this chapter we examine old companies with an enduring entrepreneurial spirit (Parasuco); we look at exciting growth-oriented newcomers (Twitter); and we examine major family organizations that have stood the test of time (McCain) and a host of small organizations with dreams and aspirations. Each of these examples gives us a glimpse of an important element of the Canadian business landscape. We begin by examining the lifeblood of an economy: small business, entrepreneurship, and new ventures.

One positive result of the recent recession was a new wave of entrepreneurial efforts. In 2009, the number of self-employed Canadians increased by 115 000.[1] Every day, approximately 380 businesses are started in Canada.[2] New firms create the most jobs, are noted for their entrepreneurship, and are typically small.[3] But does this mean that most small businesses are entrepreneurial? Not necessarily.

The terms *small business, new venture*, and *entrepreneurship* are closely linked terms, but each idea is distinct. In the following paragraphs we will explain these terms to help you understand these topics and how they are interrelated.

LO-1 Small Business

Defining a "small" business can be a bit tricky. Various measures might be used, including the number of people the business employs, the company's sales revenue, the size of the investment required, or the type of ownership structure the business has. Some of the difficulties in defining a small business can be understood by considering the way the Canadian government collects and reports information on small businesses.

© CourseSmart

Industry Canada is the main federal government agency responsible for small business. In reporting Canadian small business statistics, the government relies on two distinct sources of information, both provided by Statistics Canada: the *Business Register* (which tracks businesses) and the *Labour Force Survey* (which tracks individuals). To be included in the Register, a business must have at least one paid employee, annual sales revenues of $30 000 or more, or be incorporated (we describe incorporation later in the chapter). A goods-producing business in the Register is considered small if it has fewer than 100 employees, while a service-producing business is considered small if it has fewer than 50 employees. The Labour Force Survey uses information from *individuals* to make estimates of employment and unemployment levels. Individuals are classified as self-employed if they are working owners of a business that is either incorporated or unincorporated, if they work for themselves but do not have a business (some musicians, for example, would fall into this category), or if they work without pay in a family business.[4] In its publication *Key Small Business Statistics* (www.strategis.gc.ca/sbstatistics), Industry Canada reports that there are 2.3 million "business establishments" in Canada and about 2.6 million people who are "self-employed."[5] There is no way of identifying how much overlap there is in these two categories, but we do know that an unincorporated business operated by a self-employed person (with no employees) would not be counted among the 2.3 million *businesses* in the Register. This is an important point because the majority of businesses in Canada have no employees (just the owner), nor are they incorporated.

NASCENT ENTREPRENEURS People who are trying to start a business from scratch.

SMALL BUSINESS An independently owned and managed business that does not dominate its market.

A study by the Panel Study of Entrepreneurial Dynamics (PSED), conducted by members of the Entrepreneurship Research Consortium (ERC), tracked a sample of Canadian **nascent entrepreneurs**—people who were trying to start a business—over four years. Only 15 percent of those who reported establishing an operating business had incorporated their firm.[6]

For our purposes, we define a **small business** as an owner-managed business with less than 100 employees. We do so because it enables us to make better use of existing information, and because you are now aware of how definitions can affect our understanding of small businesses. Industry Canada estimates the percentage of small business's contribution to Canada's GDP over the past decade at 26 percent annually.[7]

Each year, the Queen's Centre for Business Venturing develops a ranking of the top 50 small- and medium-sized employers to work for. The top 10 firms in the 2010 study are shown in Table 4.1. Each of these companies exhibited superiority in employee recognition, managing performance, career opportunities, and organizational reputation.[8]

Table 4.1 Top Small and Medium-Sized Employers in Canada, 2010

	Company	Location
1.	Booty Camp Fitness Inc.	Toronto, Ontario
2.	ISL Engineering and Land Services Ltd.	Edmonton, Alberta
3.	Hood Group	Sherwood Park, Alberta
4.	RL Solutions	Toronto, Ontario
5.	Radiology Consultants Associated	Calgary, Alberta
6.	Concept Electric Ltd.	Calgary, Alberta
7.	Gibraltar Solutions Inc.	Mississauga, Ontario
8.	PEOPLEsource Staffing Solutions	Toronto, Ontario
9.	EPIC Information Solutions Inc.	Winnipeg, Manitoba
10.	Vista Projects Ltd.	Calgary, Alberta

The New Venture/Firm

Various criteria can also be used to determine when a new firm comes into existence. Three of the most common are when it was formed, whether it was incorporated, and if it sold goods and/or services.[9] A business is considered to be new if it has become operational within

A common type of small business in Canada is the convenience store. It attracts customers from its immediate area through its long hours of operation and the product lines it carries.

NEW VENTURE
A recently formed commercial organization that provides goods and/or services for sale.

ENTREPRENEURSHIP
The process of identifying an opportunity in the marketplace and accessing the resources needed to capitalize on it.

ENTREPRENEUR
A business person who accepts both the risks and the opportunities involved in creating and operating a new business venture.

INTRAPRENEURS
People who create something new within an existing large firm or organization.

the previous 12 months, if it adopts any of the main organizational forms (proprietorship, partnership, corporation, or co-operative), and if it sells goods or services. Thus, we define a **new venture** as a recently formed commercial organization that provides goods and/or services for sale.

Entrepreneurship

Entrepreneurship is the process of identifying an opportunity in the marketplace and accessing the resources needed to capitalize on that opportunity.[10] People start new businesses because they want to control their own destiny and prefer to take a chance rather than looking for a secure job. **Entrepreneurs** are people who recognize and seize these opportunities. For example, Mark Zuckerberg created Facebook, and in 2010 it had 500 million active users. He is one of the richest people in the world under the age of 30. However, it takes more than a good idea to be successful. Zuckerberg worked long hours, and he is constantly tailoring the website to suit its expanding audience.[11]

Each year, the Heritage Foundation publishes an index of economic freedom, which assesses the extent to which entrepreneurs have freedom to pursue new business opportunities. In 2010, the top three countries were Hong Kong, Singapore, and Australia, with freedom scores of 89.7, 86.1, and 82.6 respectively. Canada ranked seventh with a score of 80.4 and North Korea ranked last with a score of 1.0. Canada now ranks higher than the U.S. partly due to the U.S. government's stimulus spending, which the foundation believes will hurt the U.S. economy's long-term prospects.[12]

Small businesses often provide an environment to use personal attributes—such as creativity—that have come to be associated with entrepreneurs.[13] Because starting a business involves dealing with a great deal of uncertainty, ambiguity, and unpredictability, every new venture founder needs to exercise some of the personal attributes that entrepreneurs are noted for. But do not assume that only small business owners exhibit entrepreneurial characteristics.[14] Many successful managers in large organizations in both the public and private sectors also exhibit similar characteristics. Entrepreneurship therefore occurs in a wide range of contexts: not just in small or new commercial firms, but also in old firms, in large firms, in firms that grow slowly, in firms that grow rapidly, in non-profit organizations, and in the public sector.[15]

People who exhibit entrepreneurial characteristics and create something new within an existing firm or organization are called **intrapreneurs**. One large firm renowned for encouraging intrapreneurship is Proctor & Gamble. It has earned this reputation by having divisions that focus on creating new products for specific markets.[16] The Swiffer product line is one example. Once the basic Swiffer mop was launched successfully, a whole range of products was added, such as the Swiffer WetJet and Swiffer Dusters. A key difference between intrapreneurs and entrepreneurs is that intrapreneurs typically don't have to concern themselves with getting the resources needed to bring the new product to market, since big companies tend to have the necessary resources already available.

As we explore the entrepreneurial process later in the chapter, we will do so within a new-venture context. We begin by outlining the role of small and new businesses in the Canadian economy.

Mark Zuckerberg is the new-age entrepreneur who created Facebook, the hugely successful social networking site.

LO-2 The Role of Small and New Businesses in the Canadian Economy

As we will see in this section, small and new businesses play a key role in the Canadian economy. However, the recognition of this role has really only been acknowledged in the last two decades. Previously, large businesses were the focus of attention in terms of economic impact within industrialized nations.

Small Businesses

It may surprise you to learn that 97.8 percent of all businesses in Canada are small (they have fewer than 100 employees), and more than half of them have fewer than 5 employees. Medium-sized businesses (100–499 employees) comprise 1.9 percent of employer businesses, and large businesses (those with 500 or more employees) represent just 0.3 percent (see Figure 4.1).[17] This pattern is consistent across all provinces. While one large business has many more employees than one small business, as a group, small businesses provide more jobs than large businesses. Small businesses also lead the way when it comes to innovation and new technology.

Ontario and Quebec together account for the largest proportion of business establishments in Canada (about 57 percent), followed by the western provinces (37 percent) and the Atlantic provinces (6 percent). Northwest Territories, Yukon, and Nunavut represent just 0.3 percent of Canada's businesses.[18]

While the previous figures profile the number of businesses in Canada by size, we now look at how many people work in small- versus medium- and large-sized businesses. According to Statistics Canada, there were 10 901 100 **private sector** (companies and organizations not owned or controlled by government) employees in 2010.[19]

The distribution of employment by size of firm varies considerably across industries. Small businesses account for over two-thirds of employment in four industries: non-institutional health care (90 percent), the construction industry (77 percent), other services (73 percent), and accommodation and food (69 percent).[20] In another five industries, at least half of the workforce is employed by small businesses.

PRIVATE SECTOR
The part of the economy that is made up of companies and organizations that are not owned or controlled by the government.

One increasingly important area is the field of green technologies and green applications for businesses of all sizes. The box entitled "Small Businesses Go Green" provides information on the growing interest around environmental concerns for small business owners.

New Ventures

New firms are not only the main source of job creation, they are also responsible for the vast majority of new products and services.[21] In 2007, small business created 100 000 jobs in Canada; this represented 40 percent of all jobs that were created that year. Between 2002 and 2006, approximately 130 000 new small businesses were started each year in Canada. During that same period, an equal number of small businesses ceased operations each year.[22]

More and more women are starting their own small businesses; women now account for half of all new businesses that are formed. According to a recent Statistics Canada report, there are about 877 000 women entrepreneurs in Canada, and 47 percent of small- and medium-sized enterprises have some degree of female ownership.[23] For example, Kyla Eaglesham, the owner of Madeleines Cherry Pie and Ice Cream Parlour, left her job as a flight attendant and opened her dessert café in Toronto's trendy Annex neighbourhood. The store attracts customers who want "a little bit of cottage country in the city."[24] However, women lead only 12 percent of the small- and medium-sized businesses that export goods and services.[25]

Female entrepreneurs are honoured each year at the Canadian Woman Entrepreneur Awards. Previous winners included Cora Tsouflidou (Montreal-based Cora Franchise Group), Teresa Coady (Vancouver-based Bunting Coady Architects), and Yvonne Tollens (Okotoks, Alberta–based ComputerAid Professional Services).[26]

Women who run businesses from their homes are sometimes called "mompreneurs."[27] The Mompreneur Networking Group

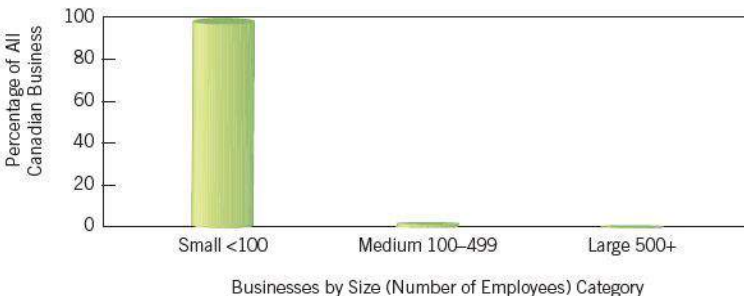

Figure 4.1
Small, medium, and large businesses as a percentage of total businesses.

THE GREENING OF BUSINESS

Small Businesses Go Green

Small business owners have plenty of operational problems that demand their attention, so they often don't spend enough time thinking about how their company could become more eco-friendly. Even if they did find the time, they might think that they couldn't afford to go green. But there are a lot of inexpensive ways that small business owners can show concern for the environment.

Simple things like changing to energy-efficient lighting and turning off photocopiers and computers overnight is a good start. The energy departments of most provinces have websites that provide information on how companies can save money by using water and energy more efficiently. For more aggressive or longer-term projects, small business owners can access the federal government's ecoACTION program website, which contains information about programs that help organizations reduce energy costs. The ecoENERGY retrofit program, for example, provides financial incentives of up to 25 percent of project costs to help small and medium-sized companies implement energy-saving projects.

Saving energy is just one possible area for improvement. There are also many other ideas that small business owners can implement, such as using recycled paper, eco-friendly cleaning supplies, and pens made of compostable material instead of plastic. And employees can be encouraged to organize car pools, bicycle to work, or use public transit.

Green Enterprise Ontario (GEO) is a group of eco-minded businesses that pay $199 each year to belong to a network where they can trade business, advice, and referrals. All of the businesses in the group are committed to activities such as sustainable purchasing, manufacturing, and recycling of products. GEO runs regular workshops on topics of importance to small businesses—for example, finance and marketing—but it also offers information on environment and social responsibility initiatives. Chris Lowry, the coordinator of the Toronto affiliate, says that many small business owners have become interested in going green after being asked "uncomfortable" questions by their children and staff members about why they aren't doing more for the environment. Small business owners are also starting to respond to social pressure from customers.

Critical Thinking Questions

1. Find a small business in your local area that is committed to being eco-friendly. Why did the owner decide to commit to having an eco-friendly business?
2. Consider the following statement: *"It is unrealistic to expect small business owners to spend much time thinking about or implementing green practices. The failure rate of small businesses is high, so small business owners have to focus all their energies on trying to ensure the survival of their businesses. They simply don't have the time (or money) to 'go green.'"* Do you agree or disagree with the statement? Explain your reasoning.

organizes seminars and publishes *Mompreneur*, a free magazine that helps women who want to start a business. More information on mompreneurs is provided in Video Case I-1 and the Entrepreneurship and New Ventures box below.

Many young entrepreneurs are also involved in creating new ventures in Canada. Consider the following examples:

- Daisy and Adam Orser were among the winners of the BDC Young Entrepreneurs Award in 2009 for their Victoria, B.C.–based company called The Root Cellar Village Green Grocer. They are capitalizing on the movement for fresh local produce and healthier lifestyles. The company already employees 50 people and the future looks bright.[28]
- The Ben Barry Agency is an Ottawa-based modelling businesses that promotes models who are considered unorthodox—various sizes and ages, different racial backgrounds, and those who have physical disabilities. The models have appeared in government advertising campaigns and on fashion runways in shopping malls. Barry works with company management to define their clientele and then chooses models who will best reflect the store's typical shoppers.[29]
- Tell Us About Us (TUAU) is a Winnipeg-based company specializing in market research and customer satisfaction programs. Owners Tyler Gompf and Scott Griffith recently signed a seven-figure deal to provide mystery shopper service to Dunkin' Donuts,

© CourseSmart

ENTREPRENEURSHIP AND NEW VENTURES

Spotlight on Mompreneurs

An increasing number of Canadian women have decided to be stay-at-home entrepreneurs (called mompreneurs). Most of them aren't trying to be supermoms that can do everything; rather, they want to use their skills to run a business and at the same time achieve a better work-life balance. Here are some of their interesting success stories.

Laughing Belly Productions

Shirley Broback won the SavvyMom Entrepreneur of the Year Award in 2009. She earned the acknowledgement for her work in organizing the Vancouver Island Baby Fair. Shirley has put her event planning background to good use. She designs these events to provide an enjoyable family experience while providing marketing opportunities for companies that cater to the needs of pregnant women and children from birth to preschool age.

Sweetpea Baby Food

Erin Green and Tamar Wagman started their frozen baby food company from scratch and now their organic products are distributed in over 350 stores nationally with revenues that exceed $500 000. Part of their strategy focuses on an ambassador program for women from across Canada enlisted to make Sweatpea Baby Food a success. This grassroots approach makes a lot of sense. Moms love to talk about how they deal with their little ones; in return, Sweetpea provides organic products to moms as they spread the word in their yoga classes and baby groups.

More and more women, like Shirley Broback, are starting and successfully operating their own small businesses. They now account for half of all new businesses that are formed.

Spoon Fed Soup

Carmie Nearing of Calgary had a career as a chef, but found the hours she needed to work didn't fit with raising children. She quit and got a 9-to-5 job. But that didn't satisfy her, so she decided to start her own company—called Spoon Fed Soup—to provide gourmet soups to customers. Nearing found that as her business grew, she had to hire employees and spend more and more time dealing with customers. She now realizes that she has a passion for entrepreneurship that goes beyond the simple desire to stay at home with her children.

Green Please! Inc.

Melanie Derwin of Winnipeg became interested in green living when her 20-month-old son's repeated ear and throat infections were not helped by standard antibiotics. She eventually founded Green Please! Inc., a company that provides customers with suggestions for "greening up" their lifestyle. Her company is an e-boutique offering products like bamboo crib sheets, organic cotton rattles, non-toxic toys, and organic soaps. Melanie operates on the principle that it is better to be proactive than reactive about health problems.

Some observers of the mompreneur trend have noted that things are not always as positive as they seem. Barbara Orser, a management professor at the University of Ottawa's School of Management, says that most mompreneurs work long hours, run low-growth businesses, don't make much money, and don't get benefits. She cites a Statistics Canada report showing that only 17 percent of self-employed women earn more than $30000 per year. In spite of this, increasing numbers of women are becoming mompreneurs.

Critical Thinking Questions

1. What is the difference between small business and entrepreneurship? Are mompreneurs entrepreneurs? Explain.
2. Interview a mompreneur and ask the following questions: (a) Why did you start your business? (b) What are the advantages and disadvantages of being a mompreneur?

© CourseSmart

Baskin-Robbins, and Togo's in the United States and Canada. The mystery shoppers will note any problems at a retail site and TUAU will then measure how quickly the problems are fixed.[30]

LO-3 The Entrepreneurial Process

The entrepreneurial process is like a journey (see Figure 4.2). It is influenced by the social, economic, political, and technological factors in the broader environment, but we will focus our attention on understanding the three key elements in the entrepreneurial process—the entrepreneur, the opportunity, and resources—and how they interact. As these key elements interact, they may be mismatched or well matched. For example, if an entrepreneur identifies an opportunity for a new health service but does not have the relevant background and skills to deliver the service, the business may never get off the ground. Conversely, if all three process elements are well matched, the new business will likely become operational at some point.

Since the entrepreneur is at the heart of the entrepreneurial process, considerable attention has been paid to identifying the personal characteristics of entrepreneurs. Research shows that these characteristics are wide-ranging. Some are behavioural (e.g., taking initiative), others are personality traits (e.g., independence), and still others are skills (e.g., problem-solving).[31] Some people think that entrepreneurs are rare; however, entrepreneurial characteristics have been found to be widely distributed in the population.[32] We also know that personal characteristics often have less impact on a person's action than the situation a person is in.[33] What is really important is not who the person *is* but what the person *does*.[34] Entrepreneurs must (1) identify an opportunity and (2) access resources.

Identifying Opportunities

Identifying opportunities involves generating ideas for new (or improved) products, processes, or services, screening those ideas, and developing the best ones.

Idea Generation Typically, generating ideas involves abandoning traditional assumptions about how things work and how they ought to be, and seeing what others do not. If the prospective new (or improved) product, process, or service can be profitably produced and is attractive relative to other potential venture ideas, it might present an opportunity.

Where do ideas come from? Most new ventures do not emerge from a deliberate search for viable business ideas. Rather, the majority originate from events relating to work or everyday life.[35] In fact, work experience is the most common source of ideas, accounting for 45 to 85 percent of those generated. This happens because as employees of a company, prospective entrepreneurs are familiar with the product or service, the customers, the suppliers, and the competitors. They are also aware of marketplace needs, can relate those needs to personal capabilities, and can determine whether they are capable of producing products or services that can fill the void.

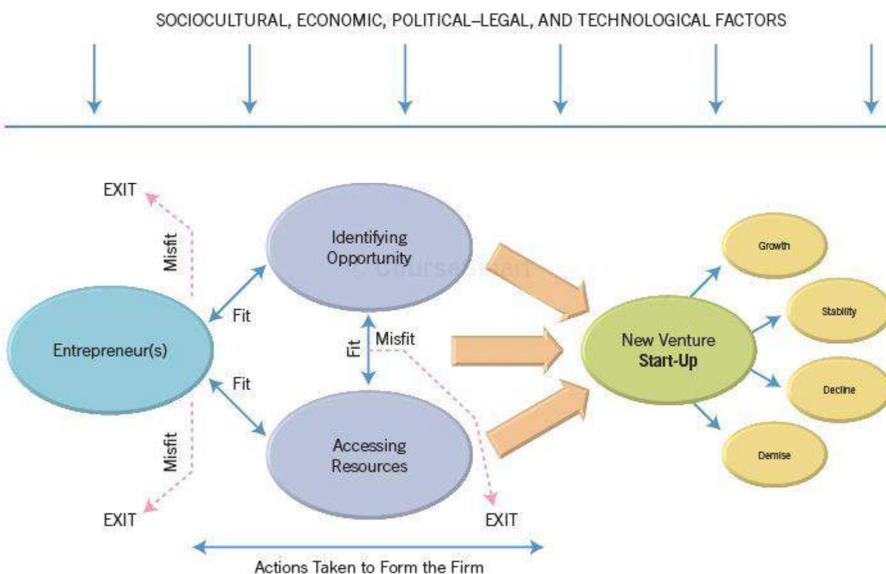

Figure 4.2 The entrepreneurial process in a new venture context.

© CourseSmart

Other frequent sources of new venture ideas include a personal interest/hobby (16 percent) or a chance happening (11 percent).[36] A chance happening refers to a situation in which a venture idea comes about unexpectedly. For example, while on vacation in another country you might try a new snack food that you feel would be in demand if introduced to the Canadian market.

Screening Entrepreneurs often generate many ideas, and screening them is a key part of the entrepreneurial process. The faster you can weed out the "dead-end" venture ideas, the more time and effort you can devote to the ones that remain. The more of the following characteristics that an idea has, the greater the opportunity it presents.

The Idea Creates or Adds Value for the Customer A product or service that creates or adds value for the customer is one that solves a significant problem, or meets a significant need in new or different ways. Consider Sally Fox's idea for eliminating the dyeing process in textile operations.[37] By cross-breeding long-fibre white cotton and short-fibre coloured cotton she developed FoxFibre, an environmentally friendly new cotton fibre that is naturally grown in several colours and is long enough to be spun commercially.

The Idea Provides a Competitive Advantage That Can Be Sustained A competitive advantage exists when potential customers see the product or service as better than that of competitors. Toronto-based Sentinelle Medical is counting on a very important sustainable advantage. Cameron Piron spent 10 years developing a better cancer detection technology and another two years to get General Electric to use it in its MRI machines. He recently received the Ontario Government Innovation Award.[38] Sustaining a competitive advantage involves maintaining it in the face of competitors' actions or changes in the industry. All other things being equal, the longer markets are in a state of flux, the greater the likelihood of being able to sustain a competitive advantage. The absence of a competitive advantage or developing a competitive advantage that is not sustainable constitute two fatal flaws of many new ventures.[39]

The Idea Is Marketable and Financially Viable While it is important to determine whether there are enough customers who are willing to buy the product or service, it is also important to determine whether sales will lead to profits.[40] Estimating the market demand requires an initial understanding of who the customers are, what their needs are, and how the product or service will satisfy their needs better than competitors' products will. It also requires a thorough understanding of the key competitors who can provide similar products, services, or benefits to the target customer. For example, 10 years ago few people thought that manufacturers of cellphones would be competitors of camera manufacturers in providing real-time photos through digital imaging. Customers define the competition in terms of who can best satisfy their needs.

SALES FORECAST
An estimate of how much of a product or service will be purchased by prospective customers over a specific period.

After learning about the competition and customers, the entrepreneur must prepare a **sales forecast**, which is an estimate of how much of a product or service will be purchased by the prospective customers for a specific period of time—typically one year. Total sales revenue is estimated by multiplying the units expected to be sold by the selling price. The sales forecast forms the foundation for determining the financial viability of the venture and the resources needed to start it.

Determining financial viability involves preparing financial forecasts, which are two- to three-year projections of a venture's future financial position and performance. They typically consist of an estimate of *start-up costs, a cash budget, an income statement*, and a balance sheet (see Chapter 11 for more details about these financial documents). These projections serve as the basis for decisions regarding whether to proceed with the venture, and, if so, the amount and type of financing to be used in financing the new business.

The Idea Has Low Exit Costs The final consideration is the venture's exit costs. Exit costs are low if a venture can be shut down without a significant loss of time, money, or reputation.[41] If a venture is not expected to make a profit for a number of years, its exit costs are high, since the project cannot be reasonably abandoned in the short term. For example, Toronto-based zero-emission car manufacturer Zenn Motors has very-long-term projections. On the other hand, if the venture is expected to make a profit quickly, its exit costs will be lower, making the idea more attractive.

Developing the Opportunity As the "dead-end" venture ideas are weeded out, a clear notion of the business concept and an entry strategy for pursuing it must be developed. The business concept often changes from what was originally envisioned. Some new ventures develop entirely new markets, products, and sources of competitive advantage once the needs of the marketplace and the economies of the business are better understood. So, while a vision of what is to be achieved is important, it is equally important to be responsive to new information and to be on the lookout for unanticipated opportunities. For example, if customers are not placing orders it is important to find out why and make adjustments.

New ventures use one or more of three main entry strategies: they introduce a totally new product or service;

FRANCHISE
An arrangement that gives franchisees (buyers) the right to sell the product of the franchiser (the seller).

BUSINESS PLAN
Document in which the entrepreneur summarizes her or his business strategy for the proposed new venture and how that strategy will be implemented.

they introduce a product or service that will compete directly with existing competitive offerings but adds a new twist (customization of the standard product); or they franchise.[42] A **franchise** is an arrangement in which a buyer (franchisee) purchases the right to sell the product or service of the seller (franchiser). We discuss franchising in more detail later in the chapter.

When capital requirements are high, such as when a manufacturing operation is being proposed, there is a need for considerable research and planning. Similarly, if product development or operations are fairly complex, research and analysis will be needed to ensure that the costs associated with effectively coordinating tasks will be minimized. In these circumstances, or when the aim is to attract potential investors, a comprehensive written business plan is required. A **business plan** is a document that describes the entrepreneur's proposed business venture; explains why it is an opportunity; and outlines its marketing plan, its operational and financial details, and its managers' skills and abilities.[43] The contents of a business plan are shown in Table 4.2.

If market conditions are changing rapidly, the benefits gained from extensive research and planning diminish quickly. By the time the entrepreneur is ready to start, new competitors may have entered the market, prices may have changed, a location may no longer be available, and so on. Similarly, if the product is highly innovative, market research is of less value, since the development of entirely new products involves *creating* needs and wants rather than simply responding to existing needs. Consequently, measuring the capacity of the product or service to fill existing customer needs or wants is less critical.

Contrary to what many people think, planning does not have to be completed before action is taken. For example, if an electrical contracting business is being proposed in an area where there is a shortage of tradespeople, it would be important to seek out qualified employees prior to conducting other analyses that are needed to complete the business plan. Such early action also helps to build relationships that can be drawn on later. Obviously, some ventures do not lend themselves to early action, particularly those that are capital intensive. Since most entrepreneurs have limited resources,

Table 4.2 A Business Plan

A well-written business plan is formally structured, easy to read, and avoids confusion. Organizing the information into sections makes it more manageable. The amount of detail and the order of presentation may vary from one venture to another and according to the intended audience (if the plan is intended for potential investors it will require more detail than if it is intended for internal use by the entrepreneur). An outline for a standard business plan is provided below.

I.	**Cover Page:** Name of venture and owners, date prepared, contact person, his/her address, telephone and fax numbers, email address, Facebook link, and the name of the organization the plan is being presented to. The easier it is for the reader to contact the entrepreneur, the more likely the contact will occur.
II.	**Executive Summary:** A one- to three-page overview of the total business plan. Written after the other sections are completed, it highlights their significant points, and aims to create enough excitement to motivate the reader to continue.
III.	**Table of Contents:** This element lists major sections with page numbers for both the body and the appendices of the plan.
IV.	**Company Description:** Identifies the type of company: manufacturing, retail, etc. It also describes the proposed form of organization: sole proprietorship, partnership, corporation, or co-operative. A typical organization of this section is as follows: name and location; company objectives; nature and primary product or service of the business; current status (start-up, buyout, or expansion) and history, if applicable; and legal form of organization.
V.	**Product or Service Description:** Describes the product or service and indicates what is unique about it. This section explains the value that is added for customers—why people will buy the product or service; features of the product or service providing a competitive advantage; legal protection (patents, copyrights, trademarks, if relevant); and dangers of technical or style obsolescence.
VI.	**Marketing:** This section has two key parts, the market analysis and the marketing plan. The market analysis convinces the reader that the entrepreneur understands the market for the product or service and can deal effectively with the competition to achieve sales projections. The marketing plan explains the strategy for achieving sales projections.
VII.	**Operating Plan:** Explains the type of manufacturing or operating system to be used. Describes the facilities, labour, raw materials, and processing requirements.
VIII.	**Management:** Identifies the key players—the management team, active investors, and directors—and cites the experience and competence they possess. This section includes a description of the management team, outside investors and directors and their qualifications, outside resource people, and plans for recruiting and training employees.
IX.	**Financial Plan:** Specifies financial needs and expected financing sources. Presents projected financial statements, including cash budget, balance sheet, and income statement.
X.	**Supporting Details/Appendix:** Provides supplementary materials to the plan such as resumés and other supporting data.

it is important to concentrate on the issues that can be dealt with, *and* that will help determine whether to proceed and how to proceed.[44]

Accessing Resources

Typically, entrepreneurs acquire the various resources needed to make the venture a reality by **bootstrapping**, which means "doing more with less." Usually the term refers to financing techniques whereby entrepreneurs make do with as few resources as possible and use other peoples' resources wherever they can. However, bootstrapping can also refer to the acquisition of other types of resources, such as people, space, equipment, or materials that are loaned or provided free by customers or suppliers.

Financial Resources There are two main types of financing—*debt* and *equity* (see Chapter 15). Since a business is at its riskiest point during the start-up phase, equity is usually more appropriate and accessible than debt. However, most new venture founders prefer debt because they are reluctant to give up any control to outsiders. To obtain debt financing, the entrepreneur must have an adequate equity investment in the business—typically 20 percent of the business's value—and collateral (or security).

Collateral refers to items (assets) owned by the business (such as a building and equipment) or by the individual (such as a house or car) that the borrower uses to secure a loan or other credit. These items can be seized by the lender if the loan isn't repaid according to the specified terms. To lenders, equity investment demonstrates the commitment of the entrepreneur, as individuals tend to be more committed to a venture if they have a substantial portion of what they own invested in it.

Entrepreneurs who want to obtain financing for a start-up business must have collateral such as a house or car in order to get a loan. Would you be willing to give your house or car as collateral, knowing that if you couldn't repay the loan the bank would take your house or car?

The most common sources of *equity* financing include:

1. *Personal savings.* New venture founders draw heavily on their own finances to start their businesses. Most save as much as they can in preparation for start-up.
2. *Love money.* This type of financing includes investments from friends, relatives, and business associates. It is called "love money" because it is often given more on the basis of the relationship than on the merit of the business concept.
3. *Private investors.* One popular source of equity capital is informal capital from private investors called *angels*. Usually, these investors are financially well off individuals; many are successful entrepreneurs who wish to recycle their wealth by investing in new businesses. For example, Saxx & Co. makes high-performance men's underwear. The company was started by Trent Kitsch, who developed the idea as part of a project requirement in his MBA program. He put $18000 of his own money into the company, but he needed a major cash injection to compete with the bigger companies in the industry. Eventually, he received $50 000 from a private investor in return for a 5 percent ownership stake in the business. Kitsch wants to get an additional $500 000, and he is willing to give an investor 15 percent of the business. He also wants a mentor who has experience in the business.[45]
4. *Venture capitalists.* Investments by venture capitalists come from professionally managed pools of investor money (venture capital). Since the risk of receiving little or no return on investment is high, only deals that present an attractive, high-growth business opportunity with a return between 35 and 50 percent are considered. Very few new ventures meet this criterion. Venture capital investment in Canada dropped to $1 billion in 2009—the lowest level in about 15 years—so angels are becoming more important in providing start-up money to entrepreneurs.[46] In a move to improve the environment and increase financing options, the Canadian government reduced red-tape hurdles for foreign venture capital firms to invest in Canada. Among other things, it eliminated a punitive 25 percent tax on capital gains aimed at foreign investors. This is good news for firms looking at the venture capital route.[47]

BOOTSTRAPPING
Doing more with less.

COLLATERAL
Assets that a borrower uses to secure a loan or other credit, and that are subject to seizure by the lender if the loan isn't repaid according to the specified repayment terms.

INCUBATORS
Facilities that support small businesses during their early growth phase by providing basic services, office space, legal advice and more.

The most common sources of *debt* financing include:

1. *Financial institutions.* While commercial banks are the main providers of debt financing for established small businesses, it is usually difficult for a new business to borrow from a bank. Banks are risk averse, and loans to new businesses are considered very risky, largely because the business has yet to establish its ability to repay the loan. Typically, entrepreneurs have more luck obtaining financing for a new venture with a personal loan (as opposed to a business loan). The most common way to obtain a personal loan is to mortgage a house or borrow against the cash value of a life insurance policy. In addition to commercial banks, other sources of debt financing include trust companies, co-operatives, finance companies, equipment companies, credit unions, and government agencies. Since finance companies lend in high-risk situations, their interest rates tend to be high.
2. *Suppliers.* Another source of financing is suppliers who provide goods (e.g., inventory) or services to the entrepreneur with an agreement to bill them later. This is referred to as *trade credit*. Trade credit can be helpful in getting started, because inventory can be acquired without paying cash, freeing up money to pay other start-up costs. This type of financing is short term; 30 days is the usual payback period. The amount of trade credit available to a new firm depends on the type of business and the supplier's confidence in the firm. Frequently, though, a new business has trouble getting trade credit since its capacity to repay has not been demonstrated.

Besides these conventional sources of financing, the possibilities for bootstrap financing are endless. For example, an entrepreneur might require an advance payment from customers. Equipment can be leased rather than purchased (which reduces the risk of obsolete equipment). Office furniture can be rented, premises can be shared, and manufacturing can be subcontracted, thereby avoiding the expense of procuring material, equipment, and facilities. All of these activities free up cash that can then be used for other purposes.

Other Resources Businesses have other resources to help them with financing, legal, marketing, or operational advice or support. The federal and provincial governments have a wide range of financial assistance programs for small businesses. Among the various forms of assistance are low-interest loans, loan guarantees, interest-free loans, and wage subsidies. We examine three sources of information and assistance below: Business Development Bank of Canada, business incubators, and the internet.

Business Development Bank of Canada The Business Development Bank of Canada (BDC) has a mandate to help develop Canadian businesses, with a particular focus on small- and medium-sized companies. It provides financing, venture capital, and consulting strategies. The BDC provides services to over 28 000 businesses from coast to coast and serves them through over 100 branch offices. The BDC is a financial institution wholly owned by the Government of Canada. Information can be found at www.bdc.ca or by calling 1-877-BDC-Banx.[48]

Incubators Business **incubators** provide new businesses (newborns) with support to help nurture them into a successful future. The type of support varies but some key forms of assistance include consulting services, legal advice, accounting services, business contacts, clerical services, and office space. According to the Canadian Association of Business Incubation (CABI), business survival rates are greatly improved by getting involved with an incubator. Survival rates after five years stand at about 80 percent, which is far above the average rates for businesses that don't use incubators. You can learn more by visiting www.cabi.ca. Take a look at Table 4.3 for examples of incubators across the country.

The Internet There are countless resources available online that can help budding entrepreneurs gather research information, write a business plan, and access government grants. The banks all have major sites dedicated to small business and entrepreneurship resources. For example, Royal Bank of Canada (RBC) has a great site that provides checklists, business plan formats and samples, and advice on selecting business structures and more (www.rbcroyalbank.com/sme/index.html). There are also government sites such as the Canada Business

Table 4.3 Business Incubators across Canada

Name	Location
NRC Institute for Fuel Cell Innovation	Victoria, British Columbia
Duncan McNeill Centre for Innovation	Edmonton, Alberta
Smart Virtual Incubation Winnipeg	Winnipeg, Manitoba
AgriTech Park	Truro, Nova Scotia
The Venture Centre	Pasadena, Newfoundland
NRC Institute for Information Technology	Fredericton, New Brunswick
Mississauga Technology Business Accelerator	Mississauga, Ontario
Saskatchewan Ideas Inc.	Saskatoon, Saskatchewan
J.-Armand-Bombardier Incubator	Montreal, Quebec
LaunchPad Incubator Facility in the Atlantic Technology Centre	Charlottetown, Prince Edward Island

Services for Entrepreneurs dedicated to providing information and advice on every aspect of starting a business, including accessing government grants (www.canadabusiness.ca/eng/).

Building the Right Team

A business may be owned by one person, but entrepreneurship is not a solo process. As we have just seen, there are various stakeholders who can provide resources to the venture. When ownership is shared, decisions must be made regarding who to share it with, how much each stakeholder will own, at what cost, and under what conditions. The form of legal organization chosen affects whether ownership can be shared and whether resources can be accessed.

Deciding whether to share ownership by forming a *venture team* involves consideration of two main issues:

- *the size and scope of the venture*—How many people does the venture require? Is it a one-person operation or does it need contributions from others? Can people be hired to fill the key roles as they are required?
- *personal competencies*—What are the talents, know-how, skills, track record, contacts, and resources that the entrepreneur brings to the venture? How do these match with what the venture needs to succeed?

The nature of the team depends upon the match between the lead entrepreneur and the opportunity and how fast and aggressively he or she plans to proceed. Most teams tend to be formed in one of two ways: (1) one person has an idea (or wants to start a business), and then several associates join the team in the first few years of operation, or (2) an entire team is formed at the outset based on such factors as a shared idea, a friendship, or an experience.

The ideal team consists of people with complementary skills covering the key success areas for the business (i.e., marketing, finance, production). Small founding teams tend to work better than big ones. It is quite common for the initial team to consist of just two people—a craftsperson and a salesperson.

If the entrepreneur does not intend to establish a high-growth venture, going solo may be a realistic option. Some new venture founders bring on additional team members only as the business can afford them. Most successful solo businesses are simple types of ventures, such as small retail stores or services.[49] The odds for survival, growth, profitability, and attracting capital are increased by a team approach.[50] Read the E-Business and Social Media Solutions case "New Age Entrepreneurs" to learn about the team and the challenges behind the popular site.

Assessing the "Fit" between Elements in the Entrepreneurial Process

Assessing the "fit" between the various elements in the entrepreneurial process is an ongoing task, since the shape of the opportunity, and consequently the resources and people needed to capitalize on it, typically changes as it is developed. It is the entrepreneur who stands to gain the most by attending to these "fits" and any changes they may require, although other stakeholders, such as investors, will be considering them as well.

The Entrepreneur–Opportunity Fit The first assessment of fit is between the entrepreneur and the opportunity. The entrepreneur needs to decide whether the opportunity is something he or she *can do* and *wants to do*. A realistic self-assessment is important. Prospective ventures that are of limited personal interest and require skills and abilities that do not fit well with those of the entrepreneur should be quickly eliminated. For example, it does little good to identify an opportunity for an ecotourism business in a wilderness area if the entrepreneur loves city life and hates spending time outdoors.

Once the entrepreneur has chosen the opportunity he or she wants to pursue, the success of the venture depends heavily upon the individual or individuals involved. No matter how good the product or service concept is, as the opportunity changes shape it may demand skills a single entrepreneur lacks. This may prompt a decision either to acquire the needed skills by forming a team or by getting further training.

© CourseSmart

E-BUSINESS AND SOCIAL MEDIA SOLUTIONS

New Age Entrepreneurs: The Rise of Twitter

Entrepreneurs have effective new promotion tools thanks to social media sites. But what about the entrepreneurs who created these new information highways? Biz Stone, Jack Dorsey, and Evan Williams created and launched Twitter, the micro-blogging site, in 2006. Before Twitter, Biz Stone helped launch Blogger, Odeo, Obvious, and Xanga. He is a blogging expert who has written two books on the subject. Jack Dorsey is the inventor on the software side of the business and Evan Williams is an entrepreneur who also built internet start-ups like Pyra Labs. A good team, a good idea, and a lot of entrepreneurial spirit, and the next thing you know "tweet" and "re-tweet" are part of our everyday lexicon.

So why is Twitter so popular? It is an instantaneous source of information (not all of it useful) delivered 140 characters at a time. As the website states, it allows you to stay informed on the issues that matter most to you. Today, Twitter is heavily promoting business applications complete with cases in a section called Twitter 101 for Businesses. You can read all about some of the showcase companies. For example, Best Buy has set up "real-time twelp" for instantaneous customer feedback from their "twelp force"; customers send queries to Best Buy's famous technical "geek squad" and receive quick answers to problems. There are YouTube video demonstrations to provide insight on how to maximize Twitter for small business applications. Of course, Twitter can also be used to spread negative word of mouth about organizations, so Best Buy's proactive engaging approach is quite intelligent.

Popularity does not necessarily translate into profitability. Biz Stone has faced tough questions from reporters, analysts, and even comedians. While appearing on the Stephen Colbert show, the host mocked him by joking that Biz is obviously not short for "business model." The crowd laughed and he smiled, but the issue behind the joke was very real. Popularity is great, but popularity does not pay the bills. You need a business model that can generate profits. In 2010, Twitter executives announced the creation of "promoted tweets," which enable companies to pay for their messages to be displayed in a more prominent manner on the site while providing Twitter with a new revenue stream. Starbucks and Red Bull were among the first companies to sign up. Even before this decision, companies were using Twitter's social power. Molson used Twitter to help launch Molson 67 and create pre-launch buzz. Authors and musicians use the site to generate buzz. Now Twitter appears ready to cash in on its success. Is this the beginning of sustainable revenues for Twitter? Will the tweeting masses object? It will be interesting to see how this business model evolves.

Critical Thinking Question

1. Are you in favour of promoted tweets? Debate Twitter's decision to implement this model.

The Opportunity–Resources Fit Assessing the opportunity–resources fit involves determining whether the resources needed to capitalize on the opportunity can be acquired. As the opportunity changes shape, so will the resource requirements. When challenges or risks arise, the aim is to determine whether they can be resolved and to deal with them quickly. For example, if the venture requires a greater financial investment than originally anticipated, this does not necessarily mean that the venture should be abandoned. Other options such as taking on partners or leasing rather than building a facility may be viable. Of course, some ventures may not be viable regardless of the alternatives considered.

The Entrepreneur–Resources Fit Once the resource requirements of the venture have been determined, the entrepreneur needs to assess whether he or she has the capacity to meet those requirements. For example, an entrepreneur with a stellar reputation for software development will have an easier time attracting employees for a venture specializing in software than someone with no track record. If that same entrepreneur is well connected with people in the industry, he or she will be more likely to gain commitments from customers, and in turn, investors.

Start-Up and Beyond

Entrepreneurs must make the right start-up decisions, but they must also pay attention to how the business will be run once it is started. In this section, we examine three important topics that are relevant to these issues. First,

we describe the three main ways that entrepreneurs start up a small business. Next, we look at the four main organizing options that are available to entrepreneurs. We conclude the chapter with a look at the reasons for success and failure in small business.

Starting Up a Small Business

Most entrepreneurs start up a small business in one of three ways: they start from scratch, they buy an existing business, or they buy a franchise. We have already examined the "starting from scratch" alternative in detail in the preceding section, so we turn now to the latter two alternatives.

LO-4 **Buying an Existing Business** About one-third of all new businesses that were started in the past decade were bought from someone else. Many experts recommend buying an existing business because it increases the likelihood of success; it has already proven its ability to attract customers and has established relationships with lenders, suppliers, and other stakeholders. The track record also gives potential buyers a clearer picture of what to expect than any estimate of a new business's prospects.

But an entrepreneur who buys someone else's business may not be able to avoid certain problems. For example, there may be uncertainty about the exact financial shape the business is in, the business may have a poor reputation, the location may be poor, or it may be difficult to determine an appropriate purchase price.

Taking Over a Family Business A special case of buying an existing business involves family businesses. Taking over a family business poses both opportunities and challenges. On the positive side, a family business can provide otherwise unobtainable financial and management resources; it often has a valuable reputation that can result in important community and business relationships; employee loyalty is often high; and an interested, unified family management and shareholders group may emerge. Toronto-based hosiery manufacturer Phantom Industries Inc. is an example of a family-owned business that has been successful through three generations of family members.[51]

On the other hand, major problems can arise in family businesses. There may be disagreements over which family members assume control. If the parent sells his or her interest in the business, the price to be paid may be an issue. The expectation of other family members may also be problematic. Some family members may feel that they have a right to a job, promotion, and impressive title simply because they are part of the family.[52] Choosing an appropriate successor is a key issue for continuity and it is vital to carefully groom successors over time. Finally, handling disagreements among family members about the future of the business can be a challenge. How do you fire a loved one if things are not working out?[53]

FRANCHISING AGREEMENT
Stipulates the duties and responsibilities of the franchisee and the franchiser.

Buying a Franchise If you drive around any Canadian town or city, you will notice retail outlets with names like McDonald's, Pizza Pizza, Re/Max, Canadian Tire, Chez Cora, Comfort Inn, Second Cup, and Tim Hortons. These diverse businesses all have one thing in common: they are all franchises, operating under licences issued by parent companies to local entrepreneurs who own and manage them.

A **franchising agreement** outlines the duties and responsibilities of each party. It stipulates the amount and type of payment that franchisees must make to the franchiser. These franchise agreements have become increasingly complicated; they are often 60 or even 100 pages long. Tim Hortons avoids this trend with a streamlined contract of about 26 pages.[54] Franchisees usually make an initial payment for the right to operate an outlet. They also make royalty payment to the franchiser ranging from 2 to 30 percent of the franchisee's annual revenues or profits. The franchisee may also pay an advertising fee to the franchiser. Franchise fees vary widely, from $23 500 for a Mad Science franchise, to over $1 million for a Burger King franchise, to hundreds of millions for a professional sports franchise.

Franchising is very popular in Canada. It offers individuals who want to run their own business an opportunity to establish themselves quickly in a local market.

© CourseSmart

SOLE PROPRIETORSHIP Business owned and usually operated by one person who is responsible for all of its debts.

The Advantages of Franchising Both franchisers and franchisees benefit from the franchising way of doing business (see Table 4.4).

The Disadvantages of Franchising There are always two sides to any story. Table 4.4 clearly outlines the obvious advantages. However, many experienced people will tell you that buying a franchise is like buying a job. The agreements are long because franchisers want to protect their image and recipes, and they want franchisees to abide by their rules. If they don't, they may be sued. If you have a great new breakfast menu idea for your store and have creative promotional ideas, then franchising may not be for you. If things go well it can be lucrative, but it is important to do your homework because there are many disappointed franchise owners out there. For example, you should carefully read the agreement and ensure that your territory is protected and that you have the right of first refusal on new potential stores within a certain distance (e.g., 10–15 kilometres or exclusivity of your particular town). Some franchisees have been shocked to see their franchiser place a new franchisee a few blocks away or even across the street. Franchisees can benefit from support and advertising, but that does not come for free. For example, a Harvey's franchisee pays a 5 percent royalty fee and a 4 percent advertising fee (based on gross sales), and these fees are payable each week in addition to regular operating costs and rent.[55] There are plenty of franchisees who belong to popular chains that are barely surviving and are wondering whatever happened to that promised success.

Is Franchising for You? Do you think you would be happy being a franchisee? The answer depends on a number of factors, including your willingness to work hard, your ability to find a good franchise to buy, and the financial resources you possess. If you are thinking seriously of going into franchising, you should consider several areas of costs that you will incur:

- the franchise sales price
- expenses that will be incurred before the business opens
- training expenses
- operational expenses for the first six months
- personal financial needs for the first six months
- emergency needs

LO-5 Forms of Business Ownership

Whether they intend to run small farms, large factories, or online e-tailers, entrepreneurs must decide which form of legal ownership best suits their goals: *sole proprietorship, partnership, corporation*, or *co-operative*.

The Sole Proprietorship The **sole proprietorship** is a business owned and operated by one person. Legally, if you set up a business as a sole proprietorship, your business is considered to be an extension of yourself

Table 4.4 The Benefits of Franchising

For the Franchiser	For the Franchisee
The franchiser can attain rapid growth for the chain by signing up many franchisees in many different locations.	Franchisees own a small business that has access to big business management skills.
Franchisees share in the cost of advertising.	The franchisee does not have to build up a business from scratch.
The franchiser benefits from the investment money provided by franchisees.	Franchisee failure rates are lower than when starting one's own business.
Advertising money is spent more efficiently.	A well-advertised brand name comes with the franchise and the franchisee's outlet is instantly recognizable.
Franchisees are motivated to work hard for themselves, which creates profit for the franchiser.	The franchiser may send the franchisee to a training program run by the franchiser (e.g., the Canadian Institute of Hamburgerology run by McDonald's).
The franchiser is freed from all details of a local operation, which are handled by the franchisee.	The franchiser may visit the franchisee and provide expert advice on how to run the business.
	Economies in buying allow franchisees to get lower prices for the raw materials they must purchase.
	Financial assistance is provided by the franchiser in the form of loans; the franchiser may also help the franchisee obtain loans from local sources.
	Franchisees are their own bosses and get to keep most of the profit they make.

(and not a separate legal entity). Though usually small, a sole proprietorship may be as large as a steel mill or as small as a lemonade stand. While the majority of businesses in Canada are sole proprietorships, they account for only a small proportion of total business revenues.

Advantages of a Sole Proprietorship Freedom may be the most important benefit of a sole proprietorship. Sole proprietors answer to no one but themselves, since they don't share ownership. A sole proprietorship is also easy to form. If you operate the business under your own name, with no additions, you don't even need to register your business name to start operating as a sole proprietor—you can go into business simply by putting a sign on the door. The simplicity of legal setup procedures makes this form appealing to self-starters and independent spirits, as do the low start-up costs.

Another attractive feature is the tax benefits. Most businesses suffer losses in their early stages. Since the business and the proprietor are legally one and the same, these losses can be deducted from income the proprietor earns from personal sources other than the business.

Disadvantages of a Sole Proprietorship A major drawback is **unlimited liability**, which means that a sole proprietor is personally liable (responsible) for all debts incurred by the business. If the business fails to generate enough cash, bills must be paid out of the owner's pocket. Another disadvantage is lack of continuity: a sole proprietorship legally dissolves when the owner dies. Finally, a sole proprietorship depends on the resources of one person whose managerial and financial limitations may constrain the business. Sole proprietors often find it hard to borrow money to start up or expand. Many bankers fear that they won't be able to recover loans if the owner becomes disabled.

The Partnership A **partnership** is established when two or more individuals (partners) agree to combine their financial, managerial, and technical abilities for the purpose of operating a business for profit. This form of ownership is often used by professionals such as accountants, lawyers, and engineers. Partnerships are often an extension of a business that began as a sole proprietorship. The original owner may want to expand, or the business may have grown too big for a single person to handle.

There are two basic types of partners in a partnership. **General partners** are actively involved in managing the firm and have unlimited liability. **Limited partners** don't participate actively in the business, and their liability is limited to the amount they invested in the partnership. A **general partnership** is the most common type and is similar to the sole proprietorship in that all the (general) partners are jointly liable for the obligations of the business. The other type of partnership—the **limited partnership**—consists of at least one general partner (who has unlimited liability) and one or more limited partners. The limited partners cannot participate in the day-to-day management of the business or they risk the loss of their limited liability status.

Advantages of a Partnership The most striking advantage of a general partnership is the ability to grow by adding talent and money. Partnerships also have an easier time borrowing funds than sole proprietorships. Banks and other lending institutions prefer to make loans to enterprises that are not dependent on a single individual. Partnerships can also invite new partners to join by investing money.

Like a sole proprietorship, a partnership is simple to organize, with few legal requirements. Even so, all partnerships must begin with an agreement of some kind. It may be written, oral, or even unspoken. Wise partners, however, insist on a written agreement to avoid trouble later. This agreement should answer such questions as:

- Who invested what sums of money in the partnership?
- Who will receive what share of the partnership's profits?
- Who does what and who reports to whom?
- How may the partnership be dissolved?
- How will leftover assets be distributed among the partners?
- How would surviving partners be protected from claims by surviving heirs if a partner dies?
- How will disagreements be resolved?

The partnership agreement is strictly a private document. No laws require partners to file an agreement with some government agency. Nor are partnerships regarded as legal entities. In the eyes of the law, a partnership is nothing more than two or more people working together.

UNLIMITED LIABILITY
A person who invests in a business is liable for all debts incurred by the business; personal possessions can be taken to pay debts.

PARTNERSHIP
A business with two or more owners who share in the operation of the firm and in financial responsibility for the firm's debts.

GENERAL PARTNER
A partner who is actively involved in managing the firm and has unlimited liability.

LIMITED PARTNER
A partner who generally does not participate actively in the business, and whose liability is limited to the amount invested in the partnership.

GENERAL PARTNERSHIP
A type of partnership in which all partners are jointly liable for the obligations of the business.

LIMITED PARTNERSHIP
A type of partnership with at least one general partner (who has unlimited liability) and one or more limited partners. The limited partners can not participate in the day-to-day management of the business or they risk the loss of their limited liability status.

© CourseSmart

CORPORATION A business considered by law to be a legal entity separate from its owners with many of the legal rights and privileges of a person; a form of business organization in which the liability of the owners is limited to their investment in the firm.

STOCKHOLDERS Investors who buy shares of ownership in the form of stock.

COMMON STOCK Shares whose owners usually have last claim on the corporation's assets (after creditors and owners of preferred stock) but who have voting rights in the firm.

BOARD OF DIRECTORS A group of individuals elected by a firm's shareholders and charged with overseeing, and taking legal responsibility for, the firm's actions.

The partnership's lack of legal standing means that the partners are taxed as individuals.

Disadvantages of a Partnership As with sole proprietorships, unlimited liability is the greatest drawback of a general partnership. By law, each partner may be held personally liable for all debts incurred in the name of the partnership. And if any partner incurs a debt, even if the other partners know nothing about it, they are all liable if the offending partner cannot pay up. Another problem with partnerships is lack of continuity. When one partner dies or pulls out, a partnership dissolves legally, even if the other partners agree to stay to continue the business.

A related drawback is the difficulty of transferring ownership. No partner may sell out without the other partners' consent. Thus, the life of a partnership may depend on the ability of retiring partners to find someone compatible with the other partners to buy them out. Finally, a partnership provides little or no guidance in resolving conflicts between the partners. For example, suppose one partner wants to expand the business rapidly and the other wants it to grow slowly. If under the partnership agreement the two are equal, it may be difficult for them to decide what to do.

A practical illustration of the kinds of problems that can arise in partnerships is described in the Exercising Your Ethics assignment found at the end of the chapter.

The Corporation When you think of corporations you probably think of giant businesses such as Air Canada, Imperial Oil, or RIM. The very word "corporation" suggests bigness and power. Yet, the tiny corner newsstand has as much right to incorporate as does a giant oil refiner. And the newsstand and oil refiner have the same basic characteristics that all corporations share: legal status as a separate entity, property rights and obligations, and an indefinite lifespan. (See Table 4.5 for a list of the top 10 corporations in Canada.)

A corporation has been defined as "an artificial being, invisible, intangible, and existing only in contemplation of the law." As such, corporations may sue and be sued; buy, hold, and sell property; make and sell products to consumers; and commit crimes and be tried and punished for them. Simply defined, a **corporation** is a business that is a separate legal entity, that is liable for its own debts, and whose owners' liability is limited to their investment.

Stockholders—investors who buy shares of ownership in the form of stock—are the real owners of a corporation. (The different kinds of stockholders are described in Chapter 15.) Profits may be distributed to stockholders in the form of dividends, although corporations are not required to pay dividends. Instead, they often reinvest any profits in the business. Common stockholders have the last claim to any assets if the company folds. Dividends on **common stock** are paid on a per share basis (if a dividend is declared). Thus, a shareholder with 10 shares receives 10 times the dividend paid a shareholder with one share. *Class A* common shares always have voting rights, but *Class B* common shares usually do not. Shareholder rights advocates argue that Class B common shares prevent democracy from working in companies because controlling shareholders hold most of the Class A stock and sell non-voting Class B stock to the general public. When investors cannot attend a shareholders' meeting, they can grant voting authority to someone who will attend. This procedure, called voting by *proxy*, is the way almost all individual investors vote.

The **board of directors** is the governing body of a corporation. Its main responsibility is to ensure that the corporation is run in the best interests of the stockholders. The directors choose the president and other officers of the business and delegate the power to run the day-to-day activities of the business to those officers. The directors set policy on paying dividends, on financing major spending, and on executive salaries and benefits. Large corporations tend to have large boards with as many as 20 or 30 directors. Smaller corporations, on the other

Table 4.5 Top 10 Corporations in Canada, 2009 [56]

Company	Sales Revenues (in billions of $)
1. Manulife Financial Corp.	40.1
2. Royal Bank of Canada	38.1
3. Power Corp. of Canada	33.1
4. George Weston Ltd.	31.8
5. Petro-Canada	27.6
6. Sun Life Financial Inc.	27.5
7. Toronto-Dominion Bank	25.4
8. Bank of Nova Scotia	25.1
9. Suncor Energy Inc.	25.0
10. Onex Corp.	24.8

hand, tend to have no more than five directors. Usually, these are people with personal or professional ties to the corporation, such as family members, lawyers, and accountants. Each year, *The Globe and Mail* analyzes the governance practices of Canadian companies in four areas: board composition, compensation, shareholder rights, and disclosure. The top-ranked companies in 2010 were Loblaw Corp., George Weston Corp., and IamGold Corp. The lowest-ranked companies were Shaw Communications and Biovail.[57]

Inside directors are employees of the company and have primary responsibility for the corporation. That is, they are also top managers, such as the president and executive vice-president. **Outside directors** are not employees of the corporation in the normal course of its business. Attorneys, accountants, university officials, and executives from other firms are commonly used as outside directors.

Corporate officers are the top managers hired by the board to run the corporation on a day-to-day basis. The **chief executive officer (CEO)** is responsible for the firm's overall performance. Other corporate officers typically include the president, who is responsible for internal management, and various vice-presidents, who oversee functional areas such as marketing or operations.

Types of Corporations A **public corporation** is one whose shares of stock are widely held and available for sale to the general public. Anyone who has the funds to pay for them can buy shares of companies such as Petro-Canada, Bombardier, or Air Canada. The stock of a **private corporation**, on the other hand, is held by only a few people and is not generally available for sale. The controlling group may be a family, employees, or the management group. Pattison and Cirque du Soleil are two well-known Canadian private corporations.

Most new corporations start out as private corporations, because few investors will buy an unknown stock. As the corporation grows and develops a record of success, it may issue shares to the public as a way of raising additional money. This is called an **initial public offering** (IPO). IPOs are not very attractive to investors during stock market declines, but they become more popular when stock markets recover. This is one of the reasons why Porter Aviation withdrew plans for an IPO in mid-2010 because of the turbulent markets at the time.[58] However, others moved forward despite turbulent markets. Capital Power Corp. raised $500 million from its IPO and retailer Dollarama raised $300 million.[59]

A public corporation can also "go private," which is the reverse of going public. In 2008, Clearwater Seafoods announced that it would be taken private by a consortium led by Clearwater Fine Foods.[60] **Private equity firms** buy publicly traded companies and then take them private. They often make major changes to company operations in order to increase its value.

During the period from 2000 to 2005, many corporations converted to an **income trust** structure, which allowed them to avoid paying corporate income tax if they distributed all or most of their earnings to investors. For example, Bell Canada Enterprises could have avoided an $800 million tax bill in one year by becoming an income trust. The federal government estimated that it was going to lose billions of dollars of tax revenue because so many corporations were becoming income trusts. In a surprise move in 2006, the Canadian government announced that it would begin taxing income trusts more like corporations by 2011. This announcement caused a significant decline in the market value of income trusts and it also put an end to the rush to convert.[61] In 2010, income trusts were widely being ignored in the markets, however, according to Alex Sasso, of Hesperian Capital Management, there were many hidden gems in the market, such as Black Diamond Group, a provider of temporary workforce accommodation to the energy, mining, and other sectors.[62]

Formation of the Corporation The two most widely used methods to form a corporation are federal incorporation under the Canada Business Corporations Act and provincial incorporation under any of the provincial corporations acts. The former is used if the company is going to operate in more than one province; the latter is used if the founders intend to carry on business in only one province. Except for banks and certain insurance and loan companies, any company can be federally incorporated under the Canada Business Corporations Act. To do so, articles of incorporation must be drawn up. These articles include such information as the name of the corporation, the type

INSIDE DIRECTORS Members of a corporation's board of directors who are also full-time employees of the corporation.

OUTSIDE DIRECTORS Members of a corporation's board of directors who are not also employees of the corporation on a day-to-day basis.

CHIEF EXECUTIVE OFFICER (CEO) The highest ranking executive in a company or organization.

PUBLIC CORPORATION A business whose stock is widely held and available for sale to the general public.

PRIVATE CORPORATION A business whose stock is held by a small group of individuals and is not usually available for sale to the general public.

INITIAL PUBLIC OFFERING (IPO) Selling shares of stock in a company for the first time to a general investing public.

PRIVATE EQUITY FIRMS Companies that buy publicly traded companies and then make them private.

INCOME TRUST A structure allowing companies to avoid paying corporate income tax if they distribute all or most of their earnings to investors.

© CourseSmart

LIMITED LIABILITY
Investor liability is limited to their personal investments in the corporation; courts cannot touch the personal assets of investors in the event that the corporation goes bankrupt.

STOCK
A share of ownership in a corporation.

DOUBLE TAXATION
A corporation must pay income taxes on its profits, and then shareholders must also pay personal income taxes on the dividends they receive from the corporation.

DIVIDENDS
The amount of money, normally a portion of the profits, that is distributed to the shareholders.

CO-OPERATIVE
An organization that is formed to benefit its owners in the form of reduced prices and/or the distribution of surpluses at year-end.

and number of shares to be issued, the number of directors the corporation will have, and the location of the company's operations. The specific procedures and information required for provincial incorporation vary from province to province.

All corporations must attach the word "Limited" (Ltd./Ltée), "Incorporated" (Inc.), or "Corporation" (Corp.) to the company name to indicate clearly to customers and suppliers that the owners have limited liability for corporate debts. The same sorts of rules apply in other countries. British firms, for example, use PLC for "public limited company" and German companies use AG for "Aktiengesellschaft" (corporation).

Advantages of Incorporation The biggest advantage of the corporate structure is **limited liability**, which means that the liability of investors is limited to their personal investment in the corporation. In the event of failure, the courts may seize a corporation's assets and sell them to pay debts, but the courts cannot touch the investors' personal possessions. If, for example, you invest $25 000 in a corporation that goes bankrupt, you may lose your $25 000, but no more. In other words, $25 000 is the extent of your liability.

Another advantage of a corporation is continuity. Because it has a legal life independent of its founders and owners, a corporation can, in theory, continue forever. Shares of stock may be sold or passed on to heirs, and most corporations also benefit from the continuity provided by professional management. Finally, corporations have advantages in raising money. By selling **stock**, they expand the number of investors and available funds. The term "stock" refers to a share of ownership in a corporation. Continuity and legal status tend to make lenders more willing to grant loans to corporations.

Disadvantages of Incorporation One of the disadvantages for a new firm in forming a corporation is the cost (approximately $2500). In addition, corporations also need legal help in meeting government regulations because they are far more heavily regulated than are proprietorships or general partnerships. Some people say that **double taxation** is another problem with the corporate form of ownership. By this they mean that a corporation must pay income taxes on its profits, and then shareholders must also pay personal income taxes on the **dividends** they receive from the corporation. The dividend a corporation pays is the amount of money, normally a portion of the profits, that is distributed to the shareholders. Since dividends paid by the corporation are paid with after-tax dollars, this amounts to double taxation. Others point out that shareholders get a dividend tax credit, which largely offsets double taxation.

The Co-operative A **co-operative** is an incorporated form of business that is organized, owned, and democratically controlled by the people who use its products and services, and whose earnings are distributed on the basis of use of the co-operative rather than level of investment. As such, it is formed to benefit its owners in the form of reduced prices and/or the distribution of surpluses at year-end. The process works like this: Suppose some farmers believe they can get cheaper fertilizer prices if they form their own company and purchase in large volumes. They might then form a co-operative, which can be either federally or provincially chartered. Prices are generally lower to buyers and, at the end of the fiscal year, any surpluses are distributed to members on the basis of how much they purchased. If Farmer Jones bought 5 percent of all co-op sales, he would receive 5 percent of the surplus.

The co-operative's start-up capital usually comes from shares purchased by the co-operative's members. Sometimes all it takes to qualify for membership in a co-operative is the purchase of one share with a fixed (and often nominal) value. Federal co-operatives, however, can raise capital by issuing investment shares to members or non-members. Co-operatives, like investor-owned corporations, have directors and appointed officers.

Types of Co-operatives There are hundreds of different co-operatives, but they generally function in one of six main areas of business:

- *Consumer co-operatives*—These organizations sell goods to both members and the general public (e.g., Mountain Equipment Co-op).
- *Financial co-operatives*—These organizations operate much like banks, accepting deposits from members, giving loans, and providing chequing services (e.g., Vancouver City Savings Credit Union).
- *Insurance co-operatives*—These organizations provide many types of insurance coverage, such as life, fire, and liability (e.g., Co-operative Hail Insurance Company of Manitoba).

- *Marketing co-operatives*—These organizations sell the produce of their farm members and purchase inputs for the production process (e.g., seed and fertilizer). Some, like Federated Co-operatives, also purchase and market finished products.
- *Service co-operatives*—These organizations provide members with services, such as recreation.
- *Housing co-operatives*—These organizations provide housing for members, who purchase a share in the co-operative, which holds the title to the housing complex.

In terms of numbers, co-operatives are the least important form of ownership. However, they are of significance to society and to their members; they may provide services that are not readily available or that cost more than the members would otherwise be willing to pay. Table 4.6 compares the various forms of business ownership using different characteristics.

Advantages of a Co-operative Co-operatives have many of the same advantages as investor-owned corporations, such as limited liability of owners and continuity. A key benefit of a co-operative relates to its structure. Each member has only one vote in the affairs of the co-operative, regardless of how many shares he or she owns. This system prevents voting and financial control of the business by a few wealthy individuals. This is particularly attractive to the less-wealthy members of the co-operative.

Unlike corporations, which are not allowed a tax deduction on dividend payments made to shareholders, co-operatives are allowed to deduct patronage refunds to members out of before-tax income. Thus, income may be taxed only at the individual member level rather than at both the co-operative and member level.[63]

Disadvantages of a Co-operative One of the main disadvantages of co-operatives relates to attracting equity investment. Since the benefits from being a member of a co-operative arise through the level of use of the co-operative rather than the level of equity invested, members do not have an incentive to invest in equity capital of the co-operative. Another drawback is that democratic voting arrangements and dividends based purely on patronage discourage some entrepreneurs from forming or joining a co-operative.

LO-6 Success and Failure in Small Business

Of every 100 small businesses that begin operation, 96 will still be operating after one year, 85 after three years, and 67 after five years.[64] A study conducted by CIBC World Markets found that small businesses with above-average revenue growth were run by owners who had more education, used professional advisers, adopted the corporate form of ownership, did outsourcing work for other companies, had a high level of internet connectivity, and used the internet to sell outside Canada.[65]

Reasons for Success

Beyond the specific findings like the CIBC study, four general factors typically are cited to explain the success of small business owners:

1. *Hard work, drive, and dedication.* Small business owners must be committed to succeeding and be willing to put in the time and effort to make it happen. Long hours and few vacations generally characterize the first few years of new business ownership.
2. *Market demand for the product or service.* Careful analysis of market conditions can help small business people assess the probable reception of their products. If the area around a college has only one pizza parlour, a new pizzeria is more likely to succeed than if there are already 10 in operation.
3. *Managerial competence.* Successful small business people have a solid understanding of how to manage a business. They may acquire competence through training (taking courses), experience, or by using the expertise of others. Few, however, succeed alone or straight out of school. Most spend time in successful

Table 4.6 A Comparison of Four Forms of Business Ownership

Characteristic	Sole Proprietorship	Partnership	Corporation	Co-operative
Protection against liability for bad debts	low	low	high	high
Ease of formation	high	high	medium	medium
Permanence	low	low	high	high
Ease of ownership transfer	low	low	high	high
Ease of raising money	low	medium	high	high
Freedom from regulation	high	high	low	medium
Tax advantages	high	high	low	high

Table 4.7 Causes of Small Business Failure

Poor management skills	**Personal reasons**
■ poor delegation and organizational ability ■ lack of depth in management team ■ entrepreneurial incompetence, such as a poor understanding of finances and business markets ■ lack of experience	■ loss of interest in business ■ accident, illness ■ death ■ family problems
Inadequate marketing capabilities	**Disasters**
■ difficulty in marketing product ■ market too small, non-existent, or declining ■ too much competition ■ problems with distribution systems	■ fire ■ weather ■ strikes ■ fraud by entrepreneur or others
Inadequate financial capabilities	**Other**
■ weak skills in accounting and finance ■ lack of budgetary control ■ inadequate costing systems ■ incorrect valuation of assets ■ unable to obtain financial backing	■ mishandling of large project ■ excessive standard of living ■ lack of time to devote to business ■ difficulties with associates or partners ■ government policies change
Inadequate production capabilities	
■ poorly designed production systems ■ old and inefficient production facilities and equipment ■ inadequate control over quality ■ problems with inventory control	

companies or partner with others to bring expertise to a new business.

4. *Luck.* Luck also plays a role in the success of some firms. For example, after one entrepreneur started an environmental clean-up firm, he struggled to keep his business afloat. Then the government committed a large sum of money for toxic waste clean-up. He was able to get several large contracts, and his business is now thriving.

Reasons for Failure

Small businesses fail for many *specific* reasons (see Table 4.7). Entrepreneurs may have no control over some of these factors (for example, weather, fraud, accidents), but they can influence most items on the list. Although no set pattern has been established, four *general* factors contribute to failure:

1. *Managerial incompetence or inexperience.* Some entrepreneurs put their faith in common sense, overestimate their own managerial skills, or believe that hard work alone ensures success. If managers don't know how to make basic business decisions or don't understand basic management principles, they aren't likely to succeed in the long run.
2. *Neglect.* Some entrepreneurs try to launch ventures in their spare time, and others devote only limited time to new businesses. But starting a small business demands an overwhelming time commitment. If an entrepreneur isn't willing to put in the time and effort that a business requires, it isn't likely to survive.
3. *Weak control systems.* Effective control systems keep a business on track and alert managers to potential trouble. If the control systems don't signal impending problems, the business may be in serious trouble before obvious difficulties are spotted.
4. *Insufficient capital.* Some entrepreneurs are overly optimistic about how soon they'll start earning profits. In most cases, it takes months or even years. Amazon.com didn't earn a profit for 10 years, but obviously still required capital to pay employees and cover expenses. Experts say you need enough capital to operate six months to a year without earning a profit.[66]

On a positive note, business failures were lower than expected in the most recent recession. According to Laurie Campbell, director of the credit counselling organization Credit Canada, this was due to the fact that the recession hit the U.S. first before having an impact in Canada. Many businesses took necessary precautions to cut expenses before it hit.[67]

To improve your grade, visit the MyBusinessLab website at **www.pearsoned.ca/mybusinesslab.** This online homework and tutorial system allows you to test your understanding and generates a personalized study plan just for you. It provides you with study and practice tools directly related to this chapter's content. MyBusinessLab puts you in control of your own learning! Test yourself on the material for this chapter at **www.pearsoned.ca/mybusinesslab.**

Summary of Learning Objectives

1. **Explain the meaning and interrelationship of the terms *small business*, *new venture creation*, and *entrepreneurship*.** A small business has less than 100 employees. A new firm is one that has become operational within the previous 12 months, has adopted any of four main organizational forms—*proprietorship, partnership, corporation,* or *co-operative*—and sells goods or services. Entrepreneurship is the *process* of identifying an opportunity in the marketplace and accessing the resources needed to capitalize on it. In relation to small and/or new businesses, entrepreneurship is the process by which a small business or a new business is created.
2. **Describe the role of small and new businesses in the Canadian economy.** While 98 percent of employer businesses in Canada are small (less than 100 employees), about half of the total private sector labour force work for small businesses. The distribution of employment by size of firm varies across industries. The small business sector's capacity for entrepreneurship and innovation accounts for much of the job creation; this sector contributes to the economy, with start-ups accounting for most of the growth. Women are playing a major role in the growth of small businesses.
3. **Explain the *entrepreneurial process* and describe its three key elements.** The entrepreneurial process occurs within a social, political, and economic context and consists of three key elements: the *entrepreneur,* the *opportunity,* and *resources*. Entrepreneurs typically access the various resources needed by bootstrapping—doing more with less. These resources are both financial and non-financial. Two types of financing—*debt* and *equity*—can be accessed from a range of sources.
4. **Describe three alternative strategies for becoming a business owner—*starting from scratch, buying an existing business*, and *buying a franchise*.** It is necessary to work through the entrepreneurial process in order to *start a business from scratch*. Whether start-up efforts will result in a new business often depends upon how well matched the entrepreneur's skills and abilities are with the opportunity and the resources required, as well as how well matched the opportunity and resources are. Some new ventures will grow; others will decline, die, or remain stable. Generally, when someone buys an *existing business,* the odds of success are better because it has existing customers; established relationships (e.g., lenders, suppliers), and an existing track record. Potential buyers have a clearer picture of what to expect. However, the business may have a poor reputation, poor location, and it may be difficult to determine an appropriate purchase price. A special case of buying an existing business involves family businesses, which pose both opportunities and challenges. In buying a *franchise* the buyer (franchisee) purchases the right to sell the product or service of the seller (franchiser) according to the terms of the franchising agreement. In return the franchiser provides assistance with the business's start-up as well as with ongoing operations once the business opens its doors.
5. **Describe four forms of *legal organization* for a business and discuss the advantages and disadvantages of each.** *Sole proprietorships* are owned and operated by one person, are easy to set up, have low start-up costs, enjoy tax benefits, and their owners enjoy freedom. However, sole proprietorships have unlimited liability, a lack of continuity, and limited resources.

   Under a *general partnership* all partners have unlimited liability. Partnerships may lack continuity, and transferring ownership may be difficult. On the positive side, partnerships can grow by adding new talent and money, partners are taxed as individuals, and banks prefer to make loans to enterprises that are not dependent on one individual. All partnerships should have a partnership agreement.

   Corporations are separate legal entities, they have property rights and obligations, and they have indefinite life spans. They may sue and be sued; buy, hold, and sell property; make and sell products; commit crimes and be tried and punished for them. The biggest advantage of incorporation is limited liability. Other advantages include continuity, professional management, and improved ability to raise money by selling stock. Disadvantages of the corporation include high start-up costs, complexity, and *double taxation*. The vast majority of corporations are privately held. In forming a corporation, a business will incorporate federally if it is going to operate in more than one province and provincially if it is going to operate in only one province.

   A *co-operative* is an organization that is formed to benefit its owners in the form of reduced prices and/or the distribution of surpluses at year-end. On

the positive side, co-operatives are democratically controlled, enjoy limited liability, continuity, and are not subject to double taxation. The main disadvantages include difficulty in raising equity. Co-operatives usually function in one of six areas of business: consumer co-operatives, financial co-operatives, insurance co-operatives, marketing co-operatives, service co-operatives, or housing co-operatives.

6. **Identify four key reasons for success in small businesses and four key reasons for failure.** Four basic factors explain most small-business success: (1) hard work, drive, and dedication; (2) market demand for the products or services being provided; (3) managerial competence; and (4) luck. Four factors contribute to small-business failure: (1) managerial incompetence or inexperience; (2) neglect; (3) weak control systems; and (4) insufficient capital.

Questions and Exercises

Questions for Analysis

1. What are some of the problems that are encountered when we try to define the term "small business"?
2. Why are new ventures the main source of job creation and new product/service ideas?
3. Do you think that you would be a successful entrepreneur? Why or why not?
4. Consider a new product or service that has recently become available for purchase by consumers. To what extent did this product or service possess the "screening" characteristics that are described in the chapter (adding value, providing competitive advantage, etc.)?
5. Using the product or service you described in Question 4, analyze the extent to which there is a good "fit" between the various elements in the entrepreneurial process.
6. Why might a private corporation choose to remain private? Why might it choose to "go public"?

Application Exercises

7. Identify three trends—whether in fashion, lifestyle, or something else—and describe at least five ideas for capitalizing on one of them.
8. Find a newspaper or magazine article that describes someone who is an entrepreneur. Use the information provided to explain what makes this person an entrepreneur.
9. Spend some time watching what people do and how they do it, and then (a) identify two ways to make what they do easier, and (b) describe two problems you observed and identify strategies for resolving those problems.
10. Interview the owners of several small businesses in your local area. Ask them what they have done to make their businesses more environmentally friendly. If they have not done anything, ask them what has prevented them from taking the initiative to be more environmentally friendly.

TEAM EXERCISES

Building Your Business Skills

Working the Internet

Goal

To encourage students to define opportunities and problems for small companies doing business on the internet.

Situation

Suppose you and two partners own a gift basket store, specializing in special-occasion baskets for individual and corporate clients. Your business is doing well in your community, but you believe there may be opportunity for growth through a virtual storefront on the internet.

Method

Step 1 Join with two other students and assume the role of business partners. Start by researching internet businesses. Look at books and articles at the library and search the following websites for help:

- Canada Business Service Centres: www.canadabusiness.ca/eng/

- Small Business Administration (United States): www.sba.gov
- IBM Small Business Center: www.businesscenter.ibm.com
- Apple Small Business Home Page: www.apple.com/business/

These sites may lead you to other sites, so keep an open mind.

Step 2 Based on your research, determine the importance of the following small business issues:

- An analysis of changing company finances as a result of internet applications
- An analysis of your new competitive marketplace (the world) and how it affects your current marketing approach, which focuses on your local community
- Identification of sources of management advice as the expansion proceeds
- The role of technology consultants in launching and maintaining the website
- Customer service policies in your virtual environment

Follow-Up Questions

1. Do you think your business would be successful on the internet? Why or why not?
2. Based on your analysis, how will extended internet applications affect your current business practices? What specific changes are you likely to make?
3. Do you think that operating a virtual storefront will be harder or easier than doing business in your local community? Explain your answer.

Exercising Your Ethics

Public or Private? That Is the Question

The Situation

The Thomas Corporation is a very well-financed private corporation with a solid and growing product line, little debt, and a stable workforce. However, in the past few months, there has been a growing rift among the board of directors that has created considerable differences of opinion as to the future direction of the firm.

The Dilemma

Some board members believe the firm should "go public" with a stock offering. Since each board member owns a large block of corporate stock, each would make a considerable amount of money if the company went public. Other board members want to maintain the status quo as a private corporation. The biggest advantage of this approach is that the firm maintains its current ability to remain autonomous in its operations. The third faction of the board also wants to remain private but clearly has a different agenda. Those board members have identified a small public corporation that is currently one of the company's key suppliers. Their idea is to buy the supplying company, shift its assets to the parent firm, sell all of its remaining operations, terminate employees, and then outsource the production of the parts it currently buys from the firm. Their logic is that the firm would gain significant assets and lower its costs.

Team Activity

Assemble a group of four students and assign each group member to one of the following roles:

- An employee at the Thomas Corporation
- A customer of the Thomas Corporation
- An investor in the Thomas Corporation
- A board member who has not yet decided which option is best

Action Steps

1. Before discussing the situation with your group, and from the perspective of your assigned role, decide which option you think is best. Write down the reasons for your position.
2. Before discussing the situation with your group, and from the perspective of your assigned role, identify the underlying ethical issues, if any, in this situation. Write down the issues.
3. Gather your group together and reveal each member's comments on the situation. Next, reveal the ethical issues listed by each member.
4. Appoint someone to record the main points of agreement and disagreement. How do you explain the results? What accounts for any disagreement?
5. From an ethical standpoint, what is the most appropriate action that should be taken by the Thomas Corporation in this situation?
6. Develop a group response to the following question: What do you think most people would do in this situation?

Family Business

© CourseSmart

Family businesses are a prominent feature in many countries of the world. Most family businesses are small, but some are very large. In addition to the usual challenges facing business firms, family businesses often are threatened by disagreements between family members about how the business should be run. Here are some classic examples.

The Irving Family

The Irving family of New Brunswick is one of the great success stories of Canadian business. The company owns scores of businesses in oil refining, forestry, shipbuilding, food processing, publishing, transportation, and home improvement. The business was started in the nineteenth century by J.D. Irving and was expanded by his son K.C. The empire is now run by K.C.'s three sons, Arthur, J.K., and Jack, who are all in their seventies. Recently, it became clear that J.K.'s son Jim and Arthur's son Kenneth were competing for a chance to shape the company's fortunes, and they disagreed over the strategic direction the company should take. That disagreement drove a wedge between J.K. and his brothers.

This is a new situation for the Irving family, which has always presented a remarkably united front. The three brothers have a great deal of respect for each other, so when these succession tensions developed, they decided they would try to amicably divide the businesses. The energy business will go to Arthur's family, and the forestry business to J.K.'s family. Their approach contrasts sharply with what happened to the McCain family, another New Brunswick business dynasty.

The McCain Family

For many years, brothers Wallace and Harrison McCain were the key players at McCain Foods Ltd., the world's largest French fry producer. But in the mid-1990s, the two brothers had a falling out over the question of who would succeed Harrison as the CEO. Wallace wanted his son Michael to get the job, but Harrison wanted someone from outside the family to take over. After a nasty battle, Wallace was removed from the firm. He then took over Maple Leaf Foods and his son Michael eventually became CEO of that company.

The Mitchell Family

Mitchell's Gourmet Foods Inc. was a Saskatchewan-based family business. A family feud developed when Fred Mitchell claimed that his mother and his brother Charles were trying to take control of the business from him. Both sides in the dispute then sued each other. An accommodation of sorts was reached when the disputing parties agreed to divide up the assets of the company. Fred (and his wife, LuAn) kept Mitchell's, and Charles (and his wife, Camille) kept a beef plant the company owned.

The Antinori Family

Some family businesses manage to avoid feuds. The Antinori family business in Florence, Italy, has been making wine since 1385, and for 26 generations the family has somehow managed to pass on management of the company to the next generation without getting in a big fight. How do they do it? By going against conventional wisdom—which says that you should clearly separate the family's interest from the interest of the business—and instead blurring the two interests as much as possible. For example, the current CEO and his wife live on the top two floors of their fifteenth-century mansion, and the business operates on the bottom two floors. Perhaps more importantly, the company plans far into the future for a company the grandchildren can run.

Maybe there is something about the wine business that makes family feuds less likely. For example, Catherine and Anne Monna and their father, Bernard, run Cassis Monna & Filles near Quebec City. The sisters are the fifth generation of the family to be involved in the wine business.

Questions for Discussion

1. How is running a family business different from creating a business from scratch? What are the advantages? What are the disadvantages?
2. It seems as though the Antinori family has found a way to ensure that the entrepreneurial spirit is transferred from generation to generation in a positive manner. But this contrasts heavily with the experiences of many family businesses, even some of the biggest success stories. Are entrepreneurs born to be entrepreneurs or can they be created?
3. How does financing a family business differ from financing a franchise or a new start-up? Outline the unique challenges in each of these situations.

© CourseSmart

© CourseSmart

© CourseSmart

© CourseSmart