

Understanding Entrepreneurship & the Small Business

Outline

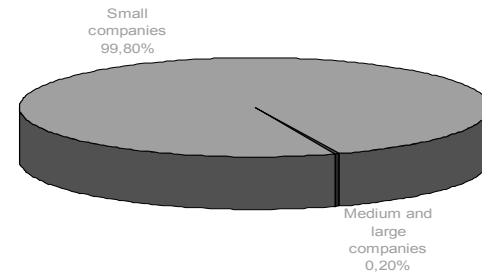
- What is a Small Business?
- Entrepreneurship
- Success and Failure in Small Business
- Starting and Operating the Small Business
- Franchising

What is a Small Business?

- Categorization of company size differs from country to country
- Generally, the categorization is based on:
 - Number of employees
 - Total gross income
 - Total investment
- **Indonesian context:**
 - The categorization is based on number of employees and total gross income
 - Small- and medium-size enterprises (SMEs):
 - Employee: less than 100 (BPS)
 - Total gross income: Rp 1.000.000.000 (Department of Industry and Trade)

The Importance of Small Business in the Indonesian Economy

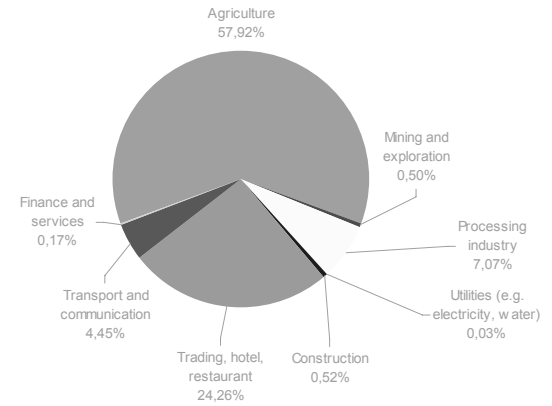
- Total companies: 38,902,303 (BPS 2000)



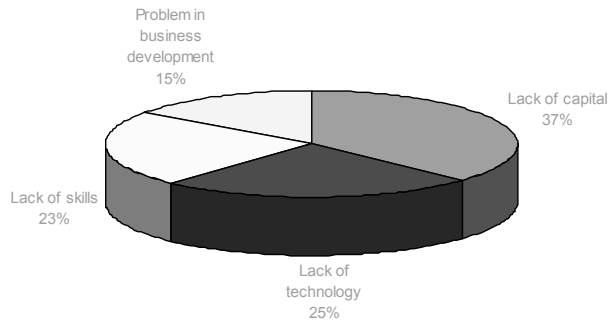
The Importance of Small Business in the Indonesian Economy

- Small and medium enterprises (SMEs) contribute to:
 - 67% of Gross Domestic Product (GDP)
 - 14,7% of total export
 - 99,44% of job creation

Small and Medium Business by Industry

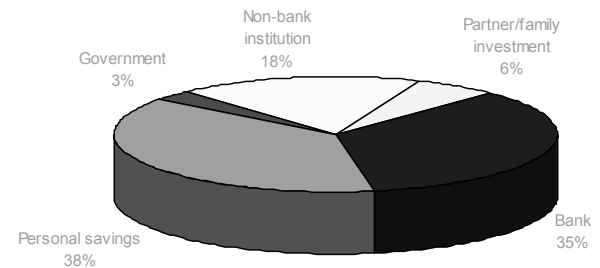


SMEs' problems



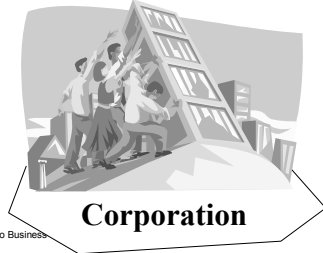
Source: *Manajemen*, September 2002

SMEs' source of capital



Source: *Manajemen*, September 2002

Types of Business Organizations



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Sole Proprietorship

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

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Sole Proprietorship

Advantages:

- Freedom
- Privacy
- Succeed or fail alone
- Simple to form
- Low start-up costs

Disadvantages:

- Unlimited liability
- ✳ Dissolves when owner dies
- ✳ Depends on resources of single individual

Unlimited Liability

Legal principle holding owners responsible for paying off all debts of a business

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Partnership

General Partnership

Business with two or more owners who share in both the operation of the firm and in financial responsibility for its debts

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Partnership

Advantages:

- New talent & money stimulate growth
- Easier to borrow money
- Resources of more than one individual
- Relatively easy to form
- Partners are taxed as individuals

Disadvantages:

- Partners share unlimited liability
- Must file specific info about business & partners
- Dissolves when partner leaves or dies
- Difficult to transfer ownership
- Internal conflict

Alternatives to General Partnership

Limited Partnership

Type of partnership consisting of limited partners and an active or managing partner

Limited Partner

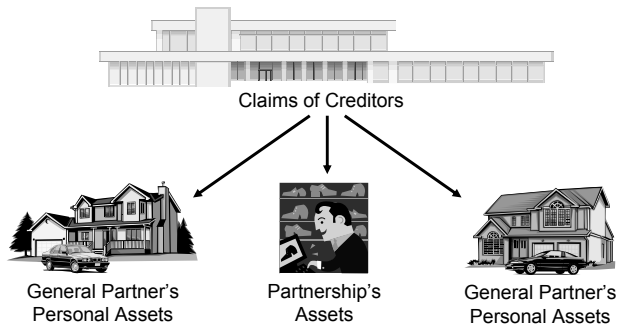
Partner who does not share in a firm's management and is liable for its debts only to the limit of his or her investment

General Partner (Active Partner)

Partner who actively manages a firm and who has unlimited liability for its debts

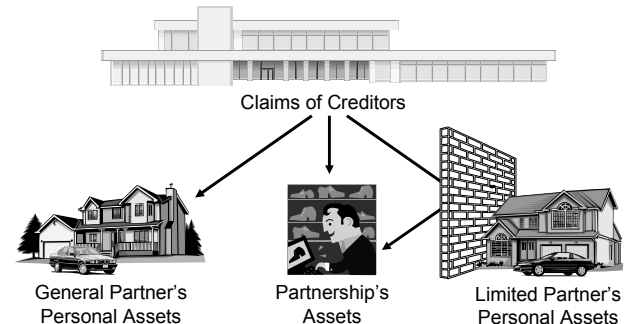
"Partnership Liability"

GENERAL PARTNERSHIP



"Partnership Liability"

LIMITED PARTNERSHIP



Alternatives to General Partnership

Master Limited Partnership

Form of organization that sells shares to investors who receive profits and pay taxes on individual income from profits

Cooperative

Group of sole proprietorships or partnerships that agree to work together for their common benefit



Corporation

Business that is legally considered an entity separate from its owners and is liable for its own debts; owners' liability extends to the limits of their investments

Corporation

Corporations may:

- Sue & be sued
- Buy, hold, & sell property
- Make & sell products to customers
- Commit crimes & be tried & punished for them

Corporation

Advantages:

- Limited liability
- Continuity
- Easy to transfer ownership
- Easy to raise money

Disadvantages:

- Tender offer
- High start-up costs
- Charter required
- Double-taxation

Corporation

Limited Liability

Legal principle holding investors liable for a firm's debts only to the limits of their personal investments in it

Tender Offer

Offer to buy shares made by a prospective buyer directly to a target corporation's shareholders, who then make individual decisions about whether to sell

Double Taxation

Situation in which taxes may be payable both by a corporation on its profits and by shareholders on dividend incomes

Types of Corporations

Closely Held (Private) Corporation

Corporation whose stock is held by only a few people and is not available for sale to the general public

Publicly Held (Public) Corporation

Corporation whose stock is widely held and available for sale to the general public

S Corporation

Hybrid of a closely held corporation and a partnership; organized and operated like a corporation, but treated as a partnership for tax purposes

Types of Corporations

Limited Liability Corporation (LLC)

Hybrid of a publicly held corporation and a partnership in which owners are taxed as partners but enjoy the benefits of limited liability

Professional Corporation

Form of ownership allowing professionals to take advantage of corporate benefits while granting them limited business liability and unlimited professional liability

Multinational or Transnational Corporation

Form of corporation spanning national boundaries

Creating and Managing a Corporation

- Creating a Corporation
- Corporate Governance
- Special Issues in Corporate Ownership

Creating a Corporation

Three basic steps:

- Consult an attorney
- Select a state in which to incorporate.
- File articles of incorporation and corporate bylaws

Creating a Corporation

Articles of Incorporation

Document detailing the corporate governance of a company, including its name and address, its purpose, and the amount of stock it intends to issue

Bylaws/regulation

Document detailing corporate rules and regulations, including election and responsibilities of directors and procedures for issuing new stock

Corporate Governance

Corporate Governance

Roles of shareholders, directors, and other managers in corporate decision making

Stockholder (or Shareholder)

Owner of shares of stock in a corporation

Stock

Share of ownership in a corporation

Stock Ownership & Stockholders' Rights

Initial Public Offering (IPO)

First offer of shares in a closely held corporation to outside investors

Preferred Stock

Guarantees holders fixed dividends and priority claims over assets but no corporate voting rights

Common Stock

Pays dividends and guarantees corporate voting rights, but offers last claims over assets

Proxy

Authorization granted by a shareholder for someone else to vote his or her shares

Boards of Directors

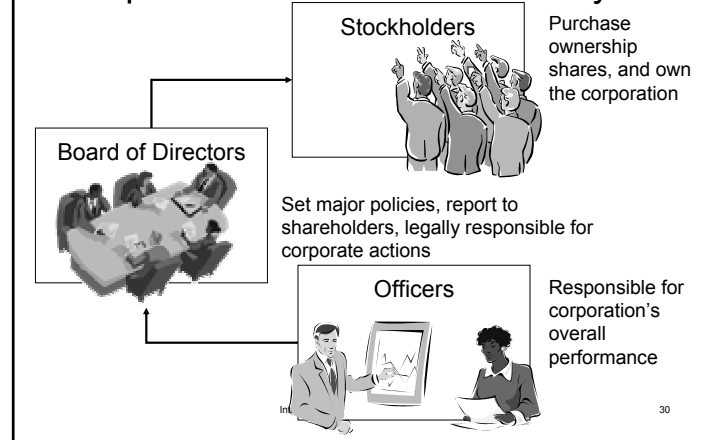
Governing body of a corporation that reports to its shareholders and delegates power to run its day-to-day operations, but remains responsible for sustaining its assets

- Inside Directors – top managers with primary responsibility for the organization
- Outside Directors – attorney’s accountants, university officials, & executives from other firms

Chief Executive Officer (CEO)

Top manager hired by the board of directors to run a corporation

“Corporate Governance Hierarchy”



Special Issues in Corporate Governance

Strategic Alliance

Strategy in which two or more organizations collaborate on a project for mutual gain

Joint Venture

Strategic alliance in which the collaboration involves joint ownership of new venture

Special Issues in Corporate Governance

Employee Stock Ownership Plan (ESOP)

Arrangement in which a corporation holds its own stock in trust for its employees, who gradually receive ownership of the stock and control its voting rights

Institutional Investors

Large investors, such as mutual funds and pension funds, that purchase large blocks of corporate stock

Special Issues in Corporate Governance

Merger

The union of two corporations to form a new corporation

Acquisition

The purchase of one company by another

Kinds of Mergers

Horizontal Merger

Merger involving firms in the same industry

Vertical Merger

Merger between firms that are customers and/or suppliers to one another

Conglomerate Merger

Merger between firms in unrelated businesses

Takeover Tactics

A takeover is considered *friendly* when the acquired company welcomes the merger

Divestitures & Spin-Offs

Divestiture

Strategy whereby a firm sells one or more of its business units

Spin-Off

Strategy of setting up one or more corporate units as new, independent corporations

Entrepreneurship

Although the concepts of *entrepreneurship* and *small business* are closely related, there are some important, though often subtle, differences between them.

The Distinction Between Entrepreneurship & Small Business

Entrepreneur

Businessperson who accepts both the risks and the opportunities involved in creating and operating a new business venture

Small business owner

Businessperson who starts a business (ex. restaurant) with no plans other to earn enough money from the restaurant

Other definitions of entrepreneur

<i>Author</i>	<i>Definition</i>
Schumpeter (1934)	An entrepreneur is a person who carries out new combinations, causing discontinuity. The carrying out of new combinations can include a new good or quality of a good, a new method of production, opening of a new market, conquest of a new source of raw materials or the reorganization of any industry.
Hoselitz (1960)	The entrepreneur is one who buys at a price that is certain and sells at a price that is uncertain.
Leibenstein (1968)	An entrepreneur is one who marshals all resources necessary to produce and market a product that answers a market deficiency.
Kirzner (1985)	An entrepreneur is one who perceived profits opportunities and initiated action to fill currently unsatisfied needs.
Bygrave and Hofer (1991)	An entrepreneur is one who perceives an opportunity and creates an organization to pursue it.

Type of entrepreneurs

- **Nascent entrepreneurs**
 - individuals considering the establishment of a new business;
- **Novice entrepreneurs**
 - individuals with no prior business ownership experience as a business founder, an inheritor or a purchaser of a business;
- **Habitual entrepreneurs**
 - individuals with prior business ownership experience;
- **Serial entrepreneurs**
 - individuals who have sold/closed the original business but at a later date have inherited, established and /or purchased another business; and
- **Portfolio entrepreneurs**
 - individuals who have retained their original business but a later date have inherited, established and /or purchased another business.

Source: Ucbasaran, et al. (2000)

Entrepreneurial Characteristics

Most successful entrepreneurs have characteristics that set them apart from most other business owners—for example:

- They are resourceful/creative
- They have a concern for good, often personal, customer relations.
- Most successful entrepreneurs also have a strong desire to be their own bosses.
- Many express a need to “gain control over my life” or “build for the family” and believe that building successful businesses will help them do it.
- They can also handle ambiguity and deal with surprises.

Manager vs entrepreneur

<i>Key Dimension</i>	<i>Manager</i>	<i>Entrepreneur</i>
Strategic orientation	Driven by resources currently controlled	Driven by perception of opportunity
Commitment to the opportunity	Evolutionary, of long duration	Revolutionary with short duration
Commitment of resources	Single staged with complete commitment upon decision	Multi stages with minimal exposure at each stages
Control of resources	Ownership or employment of required resources	Episodic use or rent of required resources
Management structure	Formalized hierarchy	Flat with multiple informal networks
Reward philosophy	Security driven and promotion oriented	Value driven and performance based

Trends in Small Business Start-Ups

Many of new businesses are started in Indonesia every year.

The following factors help account for this trend:

- The emergence of e-commerce
- Entrepreneurs who cross over from big business
- Increased opportunities for minorities and women
- New opportunities in global enterprise
- Improved rates of survival among small businesses

Reasons for Failure

- Managerial incompetence or inexperience
- Neglect
- Weak control systems
- Insufficient capital

Reasons for Success

- Hard work, drive, and dedication
- Market demand for the products or services being provided
- Luck

Starting & Operating the Small Business

The Internet, of course, is rewriting virtually all of the rules for starting and operating a small business.

Getting into business is easier and faster than ever before, there are many more potential opportunities than at any time in history, and the ability to gather and assimilate information is at an all-time high.

Starting the Small Business

Would-be entrepreneurs must decide *how* to get into business.

Should they:

- Buy Out an Existing Business?
- Start from Scratch?

When starting from scratch, entrepreneurs must determine:

- Who are my customers?
- Where are they?
- At what price will they buy my product?
- In what quantities will they buy?
- Who are my competitors?
- How will my product differ from those of my competitors?

Where can a small business owner get necessary information?

- The best way to gain knowledge about a market is to work in it before going into business in it.
- The local Yellow Pages or an Internet search will reveal many potential competitors.
- Studying magazines, books, and web sites aimed specifically at small businesses can be helpful.
- You can hire professionals to survey the market for.

Financing the Small Business

Common sources for funding are:

- Family & Friends
- Personal Savings
- Banks & Similar Lending Institutions
- Investors
- Governmental Agencies

- ⇒ Lending institutions are more likely to help finance the purchase of an existing business than a new business because the risks are better understood.
- ⇒ Individuals starting up new businesses, on the other hand, are more likely to have to rely on their personal resources.

Sources of Management Advice

- Advisory Boards
- Management Consultants
- Small-business-oriented NGOs
- Networking

Management Consultant



Independent, outside specialist hired to help managers solve business problems

Networking



Interactions among businesspeople for the purpose of discussing mutual problems and opportunities and perhaps pooling resources

Franchising

Franchise

Arrangement in which a buyer (franchisee) purchases the right to sell the good or service of the seller (franchiser)

Franchisee

Buyer

Franchiser

Seller or parent company

Advantages & Disadvantages of Franchising

ADVANTAGES

- Franchiser (parent company) supplies financial, managerial, & marketing assistance
- Franchising enables small businesses to grow rapidly
- Franchising risks are lower than those in starting a new business from scratch

DISADVANTAGES

- High cost of purchasing a franchise
- The franchisee sacrifices independence and creativity
- Owning franchises provides no guarantee of success