

Entrepreneurship, Small Business, and New Venture Creation

LO

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 Describe some key characteristics of *entrepreneurial personalities* and explain the *entrepreneurial process* and describe its 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 Identify four key reasons for success in small businesses and four key reasons for failure.
- LO-6 Describe four forms of *legal organization* for a business and discuss the advantages and disadvantages of each.

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* Tim Hortons' Franchisee Challenges: Heroes, and Villains

What does it take to be an entrepreneur? Is there a common set of characteristics? What images immediately come to mind? You are probably picturing people who launch new ideas and concepts. These individuals take significant risks to commercialize a new product or retail concept. However, another way to start a business is to take a different calculated risk by joining a pre-established franchise chain like Tim Hortons. It is not quite as exciting as launching a new venture from scratch, but the success rates are much higher. Of course, there are still no guarantees. Plenty of business people thrive within the umbrella of a franchise system, but there are also many examples of individuals who regret the day they decided to travel down that road.

When you think of Tim Hortons, you may simply see a massive chain that seems to have a location on every busy

corner in your city or town. However, most of these retail shops are run by entrepreneurs (they usually own one or two locations). They face the same challenges as independent business owners (hiring, managing staff, maximizing efficiency, controlling costs, etc.). In recent years, Tim Hortons has been a high profile case study highlighting the challenges for franchisees in the shadow of a powerful franchisor. The life of a Tim Hortons shop owner also demonstrates the harsh realities of managing a small business in an ever-changing economic climate.

Tim Hortons Franchise Revolt: Fight the Power

When you become a Tim Hortons franchisee, you gain the marketing knowledge, the business processes, and the magic formula for proven success, but in return, you pay hefty



Steve Russell/Toronto Star/Getty Images

royalty fees: (1) 4% to 6.5% of gross sales, (2) another 4% of gross sales for advertising, and (3) a lease for shop premises from 7% to 8.5% of gross sales. The franchisee must also purchase all products from the corporate head office. And that's not all. These small businesses are subject to a hard-nosed parent who demands that you follow its rules! There is not much room for entrepreneurial flair or creativity.

In late 2017, a group of Tim Hortons franchisees filed an \$850 million class action lawsuit against Restaurant Brands International (RBI), the parent company of both Tim Hortons and Burger King. The lawsuit claimed that RBI was trying to intimidate the franchisees, was interfering with the franchisees' right of association, and was trying to get rid of certain franchisees who had formed the Great White North Franchise Association (GWNFA). The complaints included charging franchisees excessive amounts for supplies, providing lower-quality ingredients, reducing profitability opportunities for franchisees, failing to meet system standards, compromising product quality, and failing to deal with health and safety concerns. The group also accused RBI of misusing the promotion fund to pay administrative expenses instead of spending it all on promoting the Tim Hortons brand. The most general complaint in the lawsuit was that RBI's cost-cutting campaign (designed to make corporate headquarters look good) was damaging the Tim Hortons brand and the financial well-being of franchisees.

RBI executives strongly disagreed with all these claims and said that the franchisees who had made public statements about the dispute were harming the company. RBI planned to take legal action against several franchisees whom they said had leaked confidential information to the press about Tim Hortons and made negative comments about the company.

Entrepreneurs often start businesses for freedom. As you can see, a franchise system is extremely restrictive, and the head office can dictate terms just as your boss does at work.

The Realities of Small Business Economics

In the fight with the corporate giant, public perception was on the side of the franchisees; however, those very same people were the villains just a few months later. In January 2018, the Ontario government increased the minimum wage from \$11.6 to \$14 per hour with an extra increase to \$15 planned in 2019. This was essentially a 30% increase in two years (a growing issue in many provinces). The net result was that franchisees found themselves scrambling to figure out how to pay for a huge increase in labour costs without the ability to raise prices for their products. Independent entrepreneurs can and usually do pass costs to consumers, but in this case that decision was up to the Tim Hortons head office, which had indicated that no such move was coming.

These entrepreneurs may agree with the government argument that all employees deserve a fair living wage. However, when governments across the nation take aggressive, quick steps, small business owners need to figure out how to make the numbers work because labour is a key cost metric. In this case, because the Tim Hortons head office refused to raise prices, many franchisees decided to cut out certain employee benefits. For example, some shops informed staff that their breaks would now be categorized as unpaid time. Was that fair? This issue gained major media attention. Despite the pressure, many of these business people defended their actions and said they had to make cuts or risk laying off employees.

Tim Hortons Franchise Ownership: The Full Picture

So, the next time you are in your local Tim Hortons, remember this: behind the big corporate machine, the frontlines are being handled by individuals working hard for their wages and people trying to run a small business, all trying to satisfy consumers like you while being squeezed by a franchisor demanding royalties and new government regulations. Although it might seem easy to pinpoint heroes and villains,

those Tim Hortons' storeowners must deal with economics 101. They need to make up for their increased costs by increasing revenues or decreasing costs, just like every other entrepreneur must to. Are their actions to cut out paid breaks and other benefits justified? You be the judge. But as a business student, make sure you understand all the facts first.

• CRITICAL THINKING QUESTIONS •

1. How does this case help to demonstrate the challenges of entrepreneurship?
2. What are the greatest differences between starting a business from scratch and joining a franchise system?
3. Business owners must always analyze the external factors (the economy, government regulations, social trends, etc.) to compete and adjust to new market realities. From the contents of the case and based on your knowledge of recent developments with Tim Hortons, what are the greatest external threats and opportunities for Tim Hortons franchisees?
4. Consider the following statement: *Franchisees should not complain about actions that a franchisor takes because franchisees sign an agreement that specifically lays out how the franchise will operate. Franchisees should be grateful to the franchisor, who provides a ready-made opportunity for individuals who want to run their own business.* Do you agree or disagree with the statement? Explain your reasoning.

HOW WILL THIS HELP ME?

A recent Gallup poll suggests that almost half of the young people surveyed were interested in entrepreneurship.¹ Even if you are not among that number, you will still be called on to interact with small businesses and entrepreneurs as a customer, as an investor, or as a client. You may also be trying to sell products or services to small businesses and entrepreneurs. One key to understanding entrepreneurship is to understand entrepreneurs themselves and what it takes for them to succeed. As an investor, you should also be well prepared to assess the market potential for new and up-and-coming businesses. This chapter discusses these and additional issues important for starting and owning a business, including the business plan, the reasons for success and failure, and the advantages and disadvantages of different kinds of ownership. We start by defining a small business and identifying its importance in the Canadian economy.



Minerva Studio/Fotolla

LO-1 INTERRELATIONSHIP OF SMALL BUSINESS, NEW VENTURE CREATION, AND ENTREPRENEURSHIP

In this chapter, we examine established companies with an enduring entrepreneurial spirit (MTY Group and Tim Hortons), exciting growth-oriented newcomers (Shopify), major family organizations that have stood the test of time (e.g., Kal Tire), 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.

Self-employed Canadians account for 15.3 percent of the workforce.² Every day, approximately 380 businesses are started in Canada.³ New firms create the most jobs, are noted for their entrepreneurship, and are typically small.⁴ But does this mean most small businesses are entrepreneurial? Not necessarily.

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

Small Business

The term *small business* is not easy to define. Locally owned and operated restaurants, dry cleaners, and hair salons are obviously small businesses, whereas giant corporations, such as Telus, Apple, and Canadian Tire, are clearly big businesses. Between these two extremes, though, fall thousands of companies that cannot be easily categorized. 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.

Industry Canada is the main federal agency responsible for small businesses. In reporting small business statistics, the government relies on two 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, have annual sales revenues of \$30 000 or more, or be incorporated (we describe incorporation later in this chapter).⁵ 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 would fall into this category), or if they work without pay in a family business.⁶ In its publication *Key Small Business Statistics* (www.strategis.gc.ca/sbststatistics), Industry Canada reports that 2.2 million “business establishments” exist in Canada and about 2.8 million people are “self-employed.”⁷ There is no way of identifying how much these two categories overlap, but we do know that an unincorporated business operated by a self-employed person (with no employees) would not be counted among the 2.2 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.

For our purposes, we define a **small business as an owner-managed business with fewer 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. According to Industry Canada's statistics, small businesses contributed approximately 30 percent of Canada's GDP over the past decade. The percentages are consistent across the country. According to research, British Columbia has the highest rate of GDP contribution from small businesses at 33 percent and Newfoundland and Labrador have the lowest percentage at 23 percent.⁸

Each year the Queen's Centre for Business Venturing, in conjunction with Aon Hewitt and *Profit* magazine, develops a ranking of the top 50 small and medium-sized employers. The top ten firms in the 2018 study are listed in Table 4.1. Each of these companies exhibited superiority in employee recognition, managing performance, career opportunities, and organizational reputation.⁹

The New Venture/Firm

Various criteria can help us determine when a new firm comes into existence. Three of the most common are: when it was formed, whether it was incorporated, and whether it sold goods and/or services.¹⁰ A business

is considered to be new if it has become operational within 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 it. 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 from his dorm room, and by 2018, the company had over 2.1 billion active users accounting for nearly one-third of the planet's population. Zuckerberg worked long hours, and he and his team continue to constantly tailor the website to suit their expanding audience.¹¹ In another example, far from the kind generally found in Silicon Valley, we find a different tale of entrepreneurial success. After growing up in Toronto and studying in Montreal, Elena Rosenfeld left life in the big city behind to set up shop in the small town of Invermere, British Columbia. She and her partner, Leo Johnson, started Kicking Horse Coffee from their garage with the mission of selling fair-trade organic coffee. Today, the company operates a huge, 60 000 square foot facility in the town they fell in love with. The company now employs more than 100 people and sells coffee across the country and in the United States. It was recently honoured as one of the Top 10 Best Workplaces in Canada.¹²

Government attitudes toward entrepreneurship can have a strong impact through laws, taxation rules, and programs designed to nurture small business. Every year, the Heritage Foundation publishes an index of economic freedom, which assesses the extent to which entrepreneurs

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

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

Company	City	Province	Industry
Addenda Capital Inc.	Montreal	QC	Finance
Axonify	Waterloo	ON	Software
BlueShore Financial	North Vancouver	BC	Credit Union
Bosa Properties	Vancouver	BC	Real Estate
Celero Solutions	Calgary	AB	IT Services
GEF Seniors Housing	Edmonton	AB	Diversified Consumer Services
NorWest Co-op Community Health	Winnipeg	MB	Health Care Providers & Services
Solvera Solutions	Regina	SK	IT Professional Services
The Berkeley Retirement Residences	Halifax	NS	Health Care Providers & Services
You.i TV	Kanata	ON	Software

<<< **TABLE 4.1** Top Small and Medium-Sized Employers in Canada, AON Rankings 2018



Courtesy of Kicking Horse Coffee

⚡ Kicking Horse Coffee is a small-town success story with a large reach across Canada and in the United States. Co-founder and CEO Elana Rosenfeld has managed to build a solid business out of selling organic, Fair Trade coffee. Take a look at Kicking Horse Coffee's new line of Cold Brew coffee.

have freedom to pursue new business opportunities. In 2017, the top three countries were Hong Kong, Singapore, and New Zealand, with freedom scores of 89.8, 88.6, and 83.7, respectively. Canada ranked seventh with a score of 78.5, and North Korea ranked last with a score of 4.9.¹³

Entrepreneurship Goals

According to the Globe Careers Leadership Lab, 72 percent of millennials dream of being business owners, and 30 percent of all Canadians want to be their own boss.¹⁴ People may decide to pursue entrepreneurship for a variety of reasons. Many entrepreneurs seek to launch a new business with the goal of independence— independence from working for someone else, coupled with some reasonable degree of financial security. Such entrepreneurs want to achieve a safe and secure financial future for themselves and their families but do not necessarily want to grow their business beyond their capacity to run it.

Other entrepreneurs, however, launch new businesses with the goal of growth and expansion—that is, to transform their venture into a large business. This was Howard Schultz's vision when he took over Starbucks; he made plans to grow and develop the coffee company into a much larger enterprise.

In still other cases, the goals of an entrepreneur may not always be clear in the early stages of business development. For instance, one entrepreneur might launch a business with little or no expectation that it will have huge growth potential but then find that it can grow dramatically. Another entrepreneur might start out with ambitious growth plans but eventually realize that the expected opportunities can't be achieved, perhaps the market is not large enough or another firm established dominance over that market first.

Entrepreneurial Characteristics

Regardless of their goals, many successful entrepreneurs share certain characteristics. Among these characteristics are resourcefulness and a

concern for good long-term customer relations. Most of them 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 deal with uncertainty and risk.

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).¹⁵ Some people think entrepreneurs are rare, but their characteristics have been found to be widely distributed in the population.¹⁶ We also know that personal characteristics often have less impact on a person's action than the situation a person is in.¹⁷ What is really important is not who the person is but what the person does.¹⁸

Consider Yoshiko Shinohara, who lost her father by the age of eight, was divorced by the age of 28, and never received a college education. At the age of 70, she is chairman and director of Tempstaff, a Japanese temp agency that she started out of her one-room apartment more than 35 years ago. Fueled by Japan's need for temporary workers during a period of stagnation in the 1990s and Shinohara's ambition, Tempstaff is now a \$3.1 billion company with a high-rise headquarters in Tokyo.¹⁹

Among other things, Shinohara's story illustrates what is almost always a key element in entrepreneurship: risk. Interestingly, most successful entrepreneurs seldom see what they do as risky. Whereas others may focus on possibilities for failure and balk at gambling on a new venture, most entrepreneurs are so passionate about their ideas and plans that they see little likelihood of failure. For example, when Shinohara started Tempstaff, few Japanese businesses understood or had even heard of the temporary worker concept. But Shinohara felt that she “had nothing to lose anyway” and preferred taking that risk to ending up “serving tea or just being a clerical assistant.”²⁰

Intrapreneurs

Many successful managers in large organizations in both public and private sectors also exhibit similar characteristics. Entrepreneurial behaviour therefore occurs in a wide range of contexts. People who exhibit entrepreneurial characteristics and create something new within an existing firm or organization are **intrapreneurs**. Procter & Gamble, 3M, and Xerox encourage intrapreneurship by having divisions that focus on creating new products for specific markets. At Telus, a recent redesign of the company's website was accomplished by a small intrapreneurial team that was given the mandate to operate in a creative manner, independent of the bureaucratic structure that characterizes large companies.²¹ A key difference between intrapreneurs and entrepreneurs is that intrapreneurs typically do not have to concern themselves with getting the resources needed to bring a new product to market because big companies tend to have the necessary resources already available.

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

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

LO-2 THE ROLE OF SMALL AND NEW BUSINESSES IN THE CANADIAN ECONOMY

Small and new businesses play a key role in the Canadian economy. However, this role was not recognized and acknowledged until the previous two decades. Prior to that time, only large businesses were the focus of attention in terms of economic impact within industrialized nations.

Small Businesses

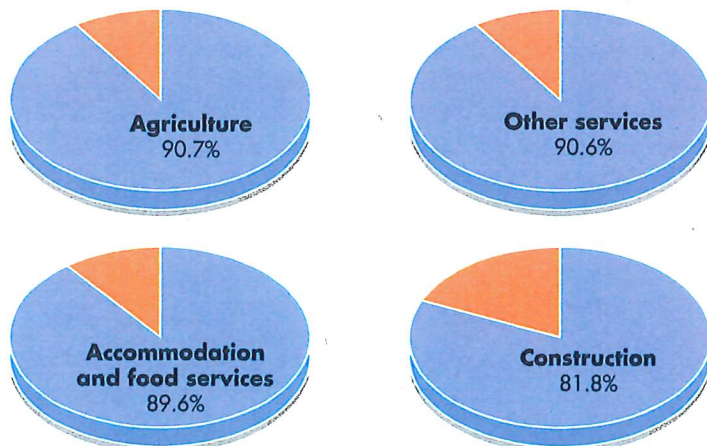
It may surprise you to learn that 97.9 percent of all businesses in Canada are small (they have fewer than 100 employees), and more than half of them have fewer than five employees. Medium-sized businesses (100 to 499 employees) make up 1.8 percent of employer businesses, and large businesses (those with 500 or more employees) represent just 0.3 percent.²² This pattern is consistent across all provinces. Although one large business has many more employees than one small business does, as a group, small businesses provide more jobs than large ones. Small businesses also lead the way when it comes to innovation and new technology.

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, in 2017, there were 11 885 600 employees in the **private sector** (the part of the economy consisting of companies and organizations not owned or controlled by the government).²³ In all industries, at least half the workforce is employed by small business. In addition, small businesses account for more than 80 percent of employment in four industries: agriculture, other services, accommodation and food services, and construction (see Figure 4.1).²⁴

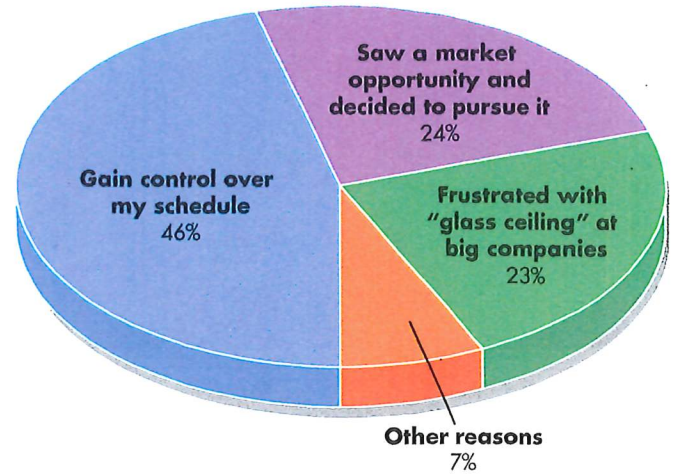
New Ventures

Not only are new firms the main source of job creation, but they are also responsible for the vast majority of new products and services. From 2005 to 2015, small businesses created 87.7 percent of all private-sector jobs in Canada (on average 100 000 per year).²⁵

Women are playing a more prominent role than ever before in starting new ventures (see Figure 4.2). More and more women are starting and successfully operating their own small businesses, and they now account for half of all new businesses formed. However, on a negative



▲ FIGURE 4.1 Small business employment



▲ FIGURE 4.2 Reasons women give for starting their own businesses

note, women lead only 12 percent of the small and medium-sized businesses that export goods and services.²⁶

The RBC Canadian Woman Entrepreneur Awards are held annually to recognize women that have made an impact. Previous winners include Trina Bailey, Bailey Veterinary Surgical Specialty Ltd., from Mount Pearl,

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



Courtesy of Hillberg & Berk

▲ Rachel Mielke, from Regina, Saskatchewan, transformed her Hillberg & Berk designer jewellery brand from a high-school hobby into a successful business.