

## Chapter 2

# Entrepreneurial Work Experience

**Abstract** This chapter is concerned first of all with the nature of entrepreneurial work and with the cognition that may well underlie this type of work. By understanding the nature of entrepreneurial work it is argued that we better understand entrepreneurs – the problems they live with and the way they think about them.

Popper writes that all sciences begin with problems. Problems are needed to direct theorizing. The central problem that this book is directed towards is explaining and predicting the financial performance of entrepreneurial firms. This chapter places the problem of entrepreneurial performance within a social and economic context of arguably related problems.

Never before has entrepreneurship been promoted in so many economies and across so many forms of media. Governments regularly pledge ongoing support for budding entrepreneurs. Universities educate many thousands of entrepreneurially-minded or curious students. Magazines celebrate the existence of entrepreneurs and television shows offer a glimpse into their lives. The objective of this chapter is to provide an overview of the nature and outcomes of entrepreneurial experience. Ten questions are posed about entrepreneurial activity and scientific evidence is provided to demonstrate the state of current knowledge. The answers are designed to provide budding researchers, educators and practitioners with a sense of the extent and limits of our knowledge.

**Question 1:** How common is entrepreneurship? How does frequency vary from one country to another?

The extent to which entrepreneurship activity appears commonplace depends to a great extent on where one lives. The Global Entrepreneurship Monitor (GEM) studies offer the best available broadly comparative data on global entrepreneurial activity. In 2011, the thirteenth GEM survey captured approximately 74 % of the global population, responsible for 87 % of global gross domestic product. The survey findings estimated that total early stage entrepreneurial activity (TEA) constituted 388 million people (aged 18–64) across 54 economies studied.

In factor-driven economies,<sup>1</sup> the estimated TEA ranged from 9.1 % (Pakistan) to 19.3 (Guatemala). In efficiency-driven economies, the estimated TEA ranged from 4.6 % (Russia) to 24 % (China). In innovation-driven economies, the estimated TEA ranged from 3.7 % (Slovenia) to 12.3 % (USA). Women constituted approximately 42 % of all people engaged in early stage entrepreneurial activity. People between the ages of 35 and 64 constituted almost 60 % of those engaged in early stage entrepreneurial activity.

It is difficult to know the extent to which the rate of entrepreneurial activity has changed for any one economy because GEM researchers have only been collecting data since 1999. Further, the GEM studies do not include all of the same economies each year.

**Question 2:** How much time do entrepreneurs spend looking for opportunities? Do ideas just come to them when they are needed or are entrepreneurs constantly on the lookout?

A key issue in entrepreneurship research is the extent to which potential entrepreneurs can appreciate the nature and extent of opportunities in advance. Shane (2003) suggests that, “The information necessary to determine whether a particular effort to exploit an opportunity will be profitable cannot be known with certainty at the time that the opportunity is identified because that information does not come into existence until the entrepreneur pursues the opportunity.”

Another way of approaching the issue is to examine the length of time required to undertake a new venture. Research findings suggest that the average time to startup is approximately 1 year (Reynolds and White 1993; Reynolds and White 1997; Carter et al. 1996). Reynolds and White (1993) found that 20 % of individuals completed gestation within 1 month and 90 % completed gestation within 3 years. Carter et al. (1996, p. 163) found that those, “...who do not begin a business or reach a decision to abandon efforts to start a business within a year are likely to remain in a constant state of abeyance...”

The question regarding how business ideas emerge is also a complicated one to answer. There are two main schools of thought on the issue: business ideas materialize as a result of entrepreneurial alertness (Kirzner 1973) or methodical search (c.f. Caplan 1999). There is some evidence that novice entrepreneurs actively search for more information about business ideas than their more experienced counterparts, serial and portfolio entrepreneurs (c.f. Cooper et al. 1995). There is also some evidence that the best ideas are generated by systematic search, an approach that leverages an individual’s knowledge and experiences to find business ideas (Fiet 2002).

**Question 3:** How difficult is it for entrepreneurs to find a quality idea? How frequently are those ideas directed to generating good financial returns more than likely to justify the risk and investment undertaken?

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<sup>1</sup>The World Economic Forum’s (WEF) Global Competitiveness Report provides definitions of economy types.

The answer to the previous question provides some insight into the difficulties associated with selecting a high-quality business idea. There is additional research that speaks to this problem, but from other angles. Bhidé (2000) examined INC 500 companies and found that it was common for the founders of the fastest growing firms in the US to select business ideas that were not innovative. Many of the business models were replications of businesses found locally. Bhidé (2000) also found that many of the entrepreneurs believed that they were fortunate, in hindsight, to select business ideas in niche markets that were of little interest to powerful companies looking for markets with obvious growth potential.

Another angle that indicates the degree of difficulty associated with selecting high quality business ideas is an examination of the track records of professional investors such as venture capitalist firms (VCFs). VCFs maintain numerous advantages over the average entrepreneur when it comes to selecting the best business ideas. First, they are arguably more objective with respect to vetting deals than entrepreneurs. Second, they invest substantial time (Fried and Hisrich 1994) and utilize specialized talent to scrutinize many business opportunities. Third, they eliminate considerable uncertainty by focusing on firms that are beyond the start-up phase. Yet, almost 60 % of venture capital backed firms fail to reach a return on investment as high as 15 % (Dean and Giglierano 1990). Zacharakis and Mayer (2000, p. 324) draw a similar conclusion: "In effect, combining data from various failure studies results in a failure rate (from the VC's perspective) ranging from 35 % to 55 %."

**Question 4:** How well prepared financially are most people at the outset to undertake the venture of their choice? How much money do they have or do they get from their own savings and assets? How much do they get from friends, relatives and business associates?

There are a number of funding sources available to entrepreneurs. The most common and immediate available source of funds comes from family, friends and personal savings. Generally speaking, the amounts are small. Bhidé's (2000, p. 37) INC 500 entrepreneurs, "...bootstrapped their ventures with meager personal savings and borrowings or funds raised from families and friends; 26 % started with less than \$5000; only 21 % raised more than \$50,000 and just two raised more than \$1 million." Bygrave's (2004, p. 58) findings about early-stage financing amounts also suggest that most entrepreneurial projects have humble beginnings from a financial perspective: "... the 25th percentile was \$379; the 75th percentile was \$6,667; the 90th percentile was \$117,787."

The other types of funding, angel and venture capital, typically occur post-start-up and are only relevant to a small number of companies. According to the US-based National Venture Capital Association (NVCA), VCFs focus on select industries that demonstrate innovation and growth such as software, Internet, media and entertainment, biotechnology and medical devices. NVCA data indicate that a total of 2,749 firms received approximately \$22 billion in 2010. Approximately 36 % (1,001) of the firms received funds for the first time. According to Shane (2008), US-based angel capital investors provide both debt and equity funding to approximately

57,300 companies per year. The number of funded companies drops to 49,800 if only equity investments are included in the analysis, which equates to approximately 0.20 % of all companies.<sup>2</sup>

**Question 5:** How well prepared otherwise are people to undertake their ventures? Do they generally know whatever they need to know before launching? How often do they have the industry and business knowledge that might be most useful?

There are at least two means to evaluate the extent to which entrepreneurs are prepared to undertake new business ventures. The first is to examine the new venture outcome data (see Question #8 below). The evidence indicates that the odds of success are low. Cassar and Craig (2009) state that, “The majority of actions performed and investments made by individuals in attempting to start a new business are in vain.”

A second approach to examining entrepreneurial preparedness is through the lens of expectations regarding new venture outcomes. In spite of well-publicized venture odds, entrepreneurs tend to favor their chances of success. For example, Cooper et al. (1988) found that existing entrepreneurs believed their odds of success to be much higher than the historical odds and the odds for similar businesses. Recently, Cassar (2010) examined such perceptions by investigating the ex-ante expectations and ex post realizations of nascent entrepreneurs. He (p. 822) found, “...substantial over optimism in nascent entrepreneurs’ expectations, in that they overestimate the probability that their nascent activity will result in an operating venture. Further, for those ventures that achieve operation, individuals overestimate the expected future sales and employment.”

**Question 6:** Why do people start businesses? What are the most common reasons people give?

The reasons for starting a business are typically categorized by either push or pull influences. The push influences are characterized by necessity, e.g., a lack of employment opportunities and a need for personal income. The 2011 Global Entrepreneurship Monitor study indicates that necessity-driven entrepreneurial activity is strongest in factor-driven economies. For example, in countries such as Guatemala, individuals report being pushed into new venturing as frequently as those who report being attracted by such activity. In efficiency-driven economics such as Malaysia, the percentage of respondents reporting push factors drops somewhat. In innovation-driven economies such as Germany, pull factors tend to dominate the reasons for new venturing.

The pull influences are many and varied. In 1988, Scheinberg and MacMillan reported the findings of an investigation of 38 motivating factors for starting a business amongst 1,402 owner-managers in 11 countries. The researchers used

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<sup>2</sup>It should be noted that the majority of new companies each year do not take a corporate form, a requirement for most angel funding (Shane 2008).

principal component analysis to derive 21 items grouped into six uncorrelated components: Need for Approval; Perceived Instrumentality of Wealth; Degree of Communitarianism; Need for Personal Development; Need for Independence; and, Need for Escape. The results indicated that the pull toward entrepreneurial activity is not dominated by any one reason.

Shane et al. (1991) used the Scheinberg and MacMillan (1988) model of reasons to examine the extent to which gender and nationality influence entrepreneurial activity in the United Kingdom, New Zealand and Norway. They (p. 441) found that, "...there are no universal reasons leading to new business formation across gender and national boundaries..." save for job freedom.

**Question 7:** How difficult is developing a business for most people?

Existing research suggests that the experience of developing a new venture is more satisfying than salaried employment, but much more demanding. Self-employed people self-report higher levels of job satisfaction than do salaried employees (Bradley and Roberts 2004; Parasuraman and Simmers 2001; Prottas and Thompson 2006). However, they work much longer hours and experience more stress and health complications. Bradley and Roberts (2004) find that the self-employed typically work more than 60 h per week. Jamal (1997) found that self-employed people spend 32 % more time at work per week than salaried employees in Canada. The results are fairly similar for visible minorities in North America (Jamal and Badawi 1995). International results also track in the same direction (c.f. Ajayi-Obe and Parker 2005).

The volume of work and/or the stress that comes with being the boss (Eden 1975) appears to take a substantial toll. Boyd and Gumpert (1983) found that approximately 65 % of a sample of 450 entrepreneurs experienced physical stress symptoms once or more per week regardless of the financial conditions of their ventures. A number of more recent studies indicate that the health of self-employed individuals is worse than that of salaried employees (Lewin-Epstein and Yuchtman-Yaar 1991; Buttner 1992; Jamal and Badawi 1995; Jamal 1997; Westerlund et al. 2004)

**Question 8:** What financial outcomes do people usually experience? What proportion of people fail? What proportion survives for more than 5 years, 10 years, etc.?

Research on the returns to entrepreneurship does not typically take into account losses suffered by those who discontinue for whatever reason. It is important to consider the data on discontinuance before discussing the outcomes for those entrepreneurs who experience survival and growth. According to Aldrich (1999), only about 50 % of pre-venture research and development activity results in the creation of a new firm. This represents a loss of time and in many cases, money. Of those ventures launched, only about 40 % survive six years (Kirchhoff and Phillips 1989; Kirchhoff 1994). It is worth noting here that substantial evidence indicates that salaried employment is much less turbulent than entrepreneurial

activity: "...self-employed workers face a greater hazard of involuntary exit from their occupation (Evans and Leighton 1989; Phillips and Kirchhoff 1989; Taylor 1999)." (Parker et al. 2005, p. C190)

For those entrepreneurs who beat the odds, the financial outcomes, generally speaking, may not be particularly inspiring. Hamilton (2000) uses 1984 panel data from the Survey of Income and Program Participation (SIPP) to generate earnings differentials between self-employment and paid employment earnings. He (p. 628–629) concludes the following based on his analysis:

Many entrepreneurs have not only lower initial earnings than employees with the same observed characteristics but also lower earnings growth. For example, the present value to the median entrepreneur of a business lasting 25 years is over 25 percent less than the present value of a paid job of the same duration. Even more striking, median self-employment earnings never overtake the alternative entry wage available on a paid job with zero job tenure. These results are generally robust to the measure of self-employment earnings used. Moreover, this self-employment differential may be a lower bound for the difference in total compensation across sectors since entrepreneurs are less likely to have health insurance. Paid employees are more likely to have all or part of their health insurance paid for by their employer. Such nonwage benefits may represent over 20 percent of paid employment compensation.

A replication study by Moskowitz and Vissing-Jorgensen (2002, p. 745) finds entrepreneurs earn returns below those who invest in passive index funds: "...we find that the returns to private equity are no higher than the returns to public equity. Given the large public equity premium, it is puzzling why households willingly invest substantial amounts in a single privately held firm with a seemingly far worse risk-return trade-off."

According to Carter (2011), there are two main criticisms that can be levied against Hamilton's (2000) findings. The first criticism is that entrepreneurial earnings are under-reported, possibly by as much as 40 % (Cagetti and De Nardi 2006; Kesselman 1989; Williams 2005). The second criticism is that household expenditure and consumption data for the self-employed is misrepresented because they have access to business-related goods, e.g. cars and computers, at low or no charge. The low cost or free goods and services effectively increase overall capability of consumption by as much as 34 % (Bradbury 1996). Recently, Astebro and Chen (2014) found, "...that entrepreneurs on average earn 4 % less per year than employees. However, after correcting for income underreporting, the mean financial gain to entrepreneurship is positive and large, greater than 42 %." According to the researchers, the finding is highly contingent on the assumptions underlying their data. In summary, the evidence on typical earnings of average entrepreneurs is mixed. Clearly more research is needed on the contingencies that account for real differences in wages.

**Question 9:** What non-financial outcomes do people experience? How often do people enjoy having their own businesses? How often do people resent the experience, in retrospect?

The existing research on non-pecuniary benefits of self-employment activity suggests that there are other rewards that may compensate for unextraordinary

financial returns to entrepreneurship. The main factor of interest is job satisfaction, which may be a function of autonomy and flexibility. Blanchflower and Oswald (1998, p. 49) examined satisfaction through the lens of happiness and concluded that the "...finding that the self-employed are happier appears to be robust." In order to rule out concerns regarding causal directionality, Blanchflower (2004, p. 22) undertook further research and found that, "...the direction of causality is clear - self-employment makes people happy, it is not the reverse direction of causality that it is happy people who decide to become self-employed." Hundley (2001, p. 302) also found that the self-employed are more satisfied with their work lives than the organizationally employed, concluding that autonomy accounted for approximately 60 % of the job-satisfaction difference. Hundley also observed that the difference in job satisfaction tended to disappear when entrepreneurs were compared with managers and established professionals. He (p. 310) speculated that the negligible difference, "...may be traceable to the fact that the self-employed in these groups have a smaller advantage in autonomy and no advantage at all in scope for skill utilization."

It may be that satisfaction is gained, in part, by setting low or realistic success thresholds that allow self-employed individuals to continue in the face of comparatively low performance (Gimeno et al. 1997). It is also conceivable that satisfaction scores are influenced by financial success. Chrisman and McMullan (2000) found that approximately two-thirds of entrepreneurs whose businesses provide an income equivalent to paid employment possibilities were either satisfied or very satisfied. By contrast, only one-third (approx.) of the entrepreneurs whose businesses had not crossed the same performance barrier reported feeling satisfaction.

A second entrepreneurial outcome of interest to both researchers and practitioners is health. A number of studies have investigated the topic, with some finding concerns (Buttner 1992; Jamal 1997; Lewin-Epstein and Yuchtman-Yaar 1991; Parslow et al. 2004; Rau et al. 2008) and others finding reassurances (Bradley and Roberts 2004; Kawakami et al. 1996; Korunka et al. 1993; Subramanian et al. 1987; Tetrick et al. 2000). A very recent study by Stephan and Roesler (2010) utilizes a nationally representative sample of entrepreneurs and employees finds the following:

...entrepreneurs exhibited better health on a number of the measures used. They showed significantly lower overall somatic and mental morbidity, lower blood pressure, lower prevalence rates of hypertension, and somatoform disorders, as well as higher well-being and more favourable self-reported behavioural health indicators (fewer physician visits and sick days). For the rest of the measures used there were no significant differences between entrepreneurs and employees. Thus, our findings lend support to the view that an entrepreneurial career may have some health benefits."

This last finding is, of course, in opposition to evidence presented in question 7 above. One might conclude that there is some confusion on the health impact of self-employment at this time.

**Question 10:** What proportion of entrepreneurs does exceptionally well? If you were just an average person what chances would you have of making your personal fortune with a business venture?

High financial returns to entrepreneurship appear to be enjoyed by relatively few individuals or superstars (Rosen 1981). Birch's (1979) finding that approximately 3 % of firms are high-growth was an early indication of the odds of extreme success. Since then, other studies have found that there are a select few big successes. Hamilton (2000, p. 623, brackets added) found that, "The EAD (equity-adjusted draw) and wage profiles for the .75 quantile suggest that a small fraction of entrepreneurs earn substantial returns, as predicted by the superstar model." Based on an Examination of 1,091 Canadian inventions, Astebro (2003, p. 226) found: "The distribution of return is skew: only between 7-9 % reach the market. Of the 75 inventions that did, six realized returns above 1400 %, 60 % obtained negative returns and the median was negative."

## **In Summary**

Thus in summation, entrepreneurial work is herein described as commonplace in participation, but uncommon in financial success. For a variety of reasons people launch unprepared, partially explaining their low rate of success. Entrepreneurship is therefore considered as work that has Herculean challenges, including finding a high quality business opportunity. It is work that is demanding of time and not infrequently niggardly in what it offers in return. People enjoy entrepreneurial work but usually because of the additional freedom it offers, and if that freedom is to be found in employment, entrepreneurship may even lose its lifestyle advantage.

Entrepreneurship is a career with high uncertainty, much ambiguity and dubious control. The winners can win big, but they are a small minority. What kind of person will such working conditions attract? What cognitive style would such a game encourage people to take? When we talk about entrepreneurship are we talking about a technology or an art form? What becomes obvious from looking at the normal practice of entrepreneurship is that the average practitioner has much to gain from an effective science of entrepreneurship.



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McMullan, W.E.; Kenworthy, Th.P.

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