Financial Enlightenment of the Entrepreneurship Dark Side from the Experience in Spain

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Abstract. This paper aims to provide financial enlightenment of what we define as the dark side of entrepreneurship. Our ideas come mainly from our experience with start-ups at Universidad Politécnica de Madrid (UPM) in Spain since 2004. The main conclusion is the development of entrepreneurial skills among the young entrepreneurs but also, we perceived the existence of a dark side of entrepreneurship associated with the risk/return equation that it seems not to be fair.

1 Introduction

This paper aims to provide financial enlightenment of what we define as the dark side of entrepreneurship. The ideas come mainly from our experience with start-ups at UPM in Spain since 2004.

Of course, the main conclusion from those experiences was the successful development of capabilities associated with professional entrepreneurship for all young entrepreneurs participating in the programs. However, it was also perceived the existence of a dark side of entrepreneurship.

1.1 Financial wealth risk/return equation

The first idea is associated with the financial wealth risk/return equation that it seems not to be fair. In a very simple way, individual entrepreneurs have not a well-diversified (in financial terms) investment.

However, start-up investors, normally enjoy a perfectly well diversified portfolio of investment. Probably, not only in start-ups but also in other bigger blue-chips companies or even in real estate investments.

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1.2 Human Wealth

The second idea is related with the concept of human wealth, the expected present discounted value of future labour earnings. The young entrepreneur has very high human wealth that it is also heavily concentrated in the start-up.

1.3 Implications

These ideas generate strange incentives. The young entrepreneur faces a situation with financial and human wealth highly concentrated. The start-up investor enjoys an attractive return and a well-diversified investment.

The question this paper wants to answer is very simple. What can be done to balance this equation and improve the financial and human wealth situation of the entrepreneur. Especially, if it is possible not to reduce the attractiveness for investors in start-ups.

Let’s review first the experience at UPM with start-ups. As we will see, it is very interesting and positive for society in general.

2 Learnings from the UPM business case

Universidad Politécnica de Madrid is one of the main European universities in the fields of engineering and architecture. More recently, the University has promoted innovation and entrepreneurship among its students and professors to strengthen technology transfer and the creation of start-ups. At the Spanish level, it has been recognized as the main Spanish university institution for the results obtained in aspects such as the creation of start-ups or the quality of the training provided in this subject.

2.1 The UPM experience since 2004

Since 2004, UPM has been implementing an entrepreneurship program among its community of students and professors during 20 editions:

- More than 6,000 teams have competed in this program through a phased process, designed to reduce the risk of unsuccessful launches.
- Approximately 10,000 people have received access to high-quality training associated with the competition.
- Even so, just 330 start-ups have been created and a percentage of less than 50% of these companies have managed to capture funds from investors, mainly private, for a total worth of more than 200 million euros.
- Establishing the company but also quitting on time has always been considered a success of the program.
- The UPM entrepreneurship program has always been considered a journey of discovery, both for the start-up project and for the internal capabilities of everyone.
- A high percentage of the program's alumni have considered their time there as a positive experience, whether they created the start-up or not.

2.2 Entrepreneurship is exciting (also toxic?)

Many times, especially young entrepreneurs, they hear motivational messages from politicians and corporate managers such as:
- “Follow your dreams”
- “Be your own boss”
- “Enjoy your freedom”

What these messages don’t tell you is that there are some things that as an entrepreneur you will find quite often, such as:

- Discrepancies with partners.
- Complaints from angry customers.
- Lack of cash.
- And that in fact, you do not have one boss but many bosses.

The truth is that maybe it is not fair to receive these inputs from people that have secure salaries from their big and not entrepreneurial at all institutions.

2.3 Becoming a professional of entrepreneurship

In these 20 years of experience, the focus has been to create an ecosystem of innovation and entrepreneurship around talent:

Fig.1. Ecosystem of innovation and entrepreneurship, UPM I&E Ecosystem 2004-2020

- The center of everything is people and the only thing you must do is adding value initiatives to highlight their talent.
- Initiatives such as specialized training based mainly on experience. Because there is no better way than learning by doing.
- Our society offers us multiple hybrid training options. We no longer only have excellent books to learn, but we also have youtube, Instagram and multiple podcasts and video
Networking activities to meet interesting people: other entrepreneurs, professors, investors, innovation managers, people who have done well and people who have done not that well creating a new venture, but who have taken advantage of the hard experience.
- Physical spaces for connection between all of them and promoting the “human touch”: classrooms for masterclasses; living-labs and co-workings where they can work collaboratively.
- Connect young students with the most experienced professors and researchers, thus achieving the perfect union between the energy that the youngest people bring, with the deep knowledge that the most senior people have.
- Honest communication and evangelization, exposing cases and examples of success, as well as the necessary tools to build solid projects.
- More advanced initiatives related to open innovation, venture building, or acceleration programs that complement the experiential process so that at the end their professional profile grows a lot.

2.4 Development of skills

The capabilities associated with entrepreneurship and the creation of a new company are reflected in aspects such as:

- Orientation towards differential contribution and achieving results, and not towards accumulating hours of work.
- Efficiency in the use of resources, which are usually scarce.
- Focus on solving complex problems in a collaborative way.
- The assumption of leadership in high-capacity teams and the orientation towards conflict resolution between members.
- The implementation of experimentation and a “learning by doing” working method.
- Strong direct communication skills, honesty, and effective sale of expectations, avoiding “selling smoke” at all times.
- Quick and massive learning of traditional disciplines such as strategy, marketing, finance and operations, as well as other softer but equally important ones such as leadership, communication, innovation and networking management.

We are witnessing the birth of a new generation of leaders and managers who can make a difference. Some of them are already achieving it, as is the case of Natalia Rodríguez, founder of Saturno Labs recognized by Forbes and who, despite her youth, is developing AI applications together with Amazon to improve the mood of patients in hospitals.

Or young people like Eugenio García, recognized by the New York Times, and who with Light Humanity is developing solar energy storage projects and implementing them in places such as inaccessible towns in the Amazon (now the jungle, not the company), allowing, for example, children to do their homework even when the sunlight has already set.

The ultimate goal, whether you want to create your own startup or not, is to acquire the skills that will make a better version of you.

3 The financial dark side of entrepreneurship
As we have seen in the previous section, yes, start-ups have in general a very positive social and economic impact, but as anticipated, the risk/return scenarios are very different for each participant.

3.1 The Capital Asset Pricing Model (CAPM)

According to the CAPM (Berk/DeMarzo), entrepreneurs suffer both systematic risk (which is non-diversifiable risk) and firm specific risk (which is a risk that can be eliminated with diversification) that normally is very high in start-ups.

However, investors in start-ups only suffer systematic risk, because they invest in well diversified portfolios. Start-up investment is attractive for them because it facilitates investors to look for high expected returns.

Finally, governments are interested in promoting entrepreneurship and start-ups investments because this brings higher economic and social growth for nations. However, high number of entrepreneurs suffer extremely high volatility and risks in their finances and in their lives. This remains mostly in the dark.

3.2 Financial and human wealth of entrepreneurs

If we consider not only the financial wealth of entrepreneurs, but also their human wealth, we see that young entrepreneurs suffer additional life risks and additional concentration of risks. Basically, the entrepreneur is concentrating in the start-up all he has and all his life. Let’s exemplify this with two anecdotes.

3.2.1 OpSeeker

OpSeeker is a start-up that was created by Professor Casanueva, one of the authors of this article, in 2016 with young students from ESCP. The students got in contact with Casanueva, and altogether decided to invest in the project.

One of the most important conditions that was established since the beginning of the project was that every six months the situation of the start-up would be reviewed. If the young entrepreneurs were satisfied with the project, if they were feeling that they were growing and learning as if they were studying a first-class MBA, the project would continue.

If in one of these reviews would be discovered that the young entrepreneurs were unhappy, the project would have been stopped, and all the effort would have been put to help them recover good corporate jobs like the ones they had abandoned at Commerzbank or Amadeus.

This was the key rule for Casanueva as investor. To ensure that the risks the young entrepreneurs were running were minimized. Casanueva, as investor, was completely sure that the young entrepreneurs were not going to destroy their lives with this strategy for the start-up. It had to be a win-win situation. The fact is that things have gone well, the entrepreneur students have grown and have been able to create a successful and profitable company.

3.2.2 Start-up X

Start-up X is a real start-up created ten years ago by two young very successful entrepreneurs to improve the life of patients with respiratory problems.
They connected with professor Casanueva to obtain help from him strategic advisor in a pro-bono basis. As a professor, it was an enjoyable and interesting activity.

One day they invited him to participate in one of their Boards with investors. The experience was cruel. Investors were just asking for money results to both entrepreneurs. They didn’t care about them personally. It was very uncomfortable to remain in the meeting.

When the meeting finished, Casanueva explained to the CEO, what he had felt and that he was very disappointed with the investors attitude. The CEO collapsed and started crying. He said that he was desperate and that his wife (a state official) had abandoned him one month ago. One year later, they closed the start-up and the CEO suffered depression during more than a year.

4 Actions to reduce the risk of entrepreneurs

The question is, what can be done to mitigate these situations? What can be done to reduce the risks for entrepreneurs like the CEO of Start-up X? Three lines of action have been identified.

4.1 Innovations in the design of programs

The first line of action is to innovate in the design of the programs to promote start-ups. For example, create cohorts of start-ups with mutualization through co-investing among them.

The result would be that all the entrepreneurs that fail in their project, would succeed a little because all of them have a small percentage of investment in all the start-up of the cohort, including the few that will succeed.

On the other hand, the few entrepreneurs that are financially successful, they must share only a small percentage of their investment with the entrepreneurs that have failed. This mutualization acts as a diversification of the financial wealth of each entrepreneur, helping to reduce greatly the firm specific financial risk.

4.2 Human risk mitigation

The second line of action refers to considerations that affect everyone at a personal level to mitigate human risks and increase personal rewards. Some examples could be:
- The development of systems to evaluate management skills growth of the entrepreneurs and create programs to develop their abilities.
- The implementation of methodologies that help entrepreneurs to develop their leadership personal skills and achieve greater life harmonization, like Total Leadership from Professor Friedman, reducing the risk of collapsing in life.

4.3 Government support

The third line of action could be ideas of possible government support: subsidies, tax advantages, management courses, health and mental support…

5 Conclusion

As a conclusion of this paper, we have found that:
- UPM has an extensive and fruitful experience developing start-ups programs in Spain.  
- The impact and the value generated for society, in general, has been very important.  
- However, there are important problems associated with the risk/reward equation for the young entrepreneurs that should be considered and mitigated.

References