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Sideline start-ups rarely transition to full-time ventures

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The majority of entrepreneurs take their first step towards self-employment through sideline start-ups. Of those, only a minority of approximately 7 % transition to full-time entrepreneurship within twelve months. The transition is more likely if the entrepreneurs have employees on their payroll, if their enterprise specialises in crafts, and if the enterprise was founded out of necessity or as an alternative to unemployment.

The advantage of a sideline start-up is that entrepreneurs can take a stab at self-employment and test out the viability of their business model. At the same time, there is the risk that start-up opportunities are not fully realised if founders limit themselves to sideline work from the outset. At the least, nascent entrepreneurs should take into account the option of full-time entrepreneurship when shaping their business idea.

Persons interested in self-employment must determine the scope of their start-up project. They can launch their enterprises on a full-time or a sideline basis and subsequently keep the scope of their self-employment unchanged. However, there is also the possibility of becoming self-employed on a sideline basis before transitioning to full-time (or vice versa). This article focuses on entrepreneurs transitioning from sideline to full-time self-employment (transitioners).

The basic features of a start-up project are influenced by the intended scope of entrepreneurship, and whether or not entrepreneurs plan to transition from side-

line to full-time. Equally, persons with certain characteristics may have a particular predestination towards switching from sideline to full-time entrepreneurship. The individual decisions regarding the scope of a start-up are taken against the background of the situation on the labour market and the unemployment rate, and their respective changes.

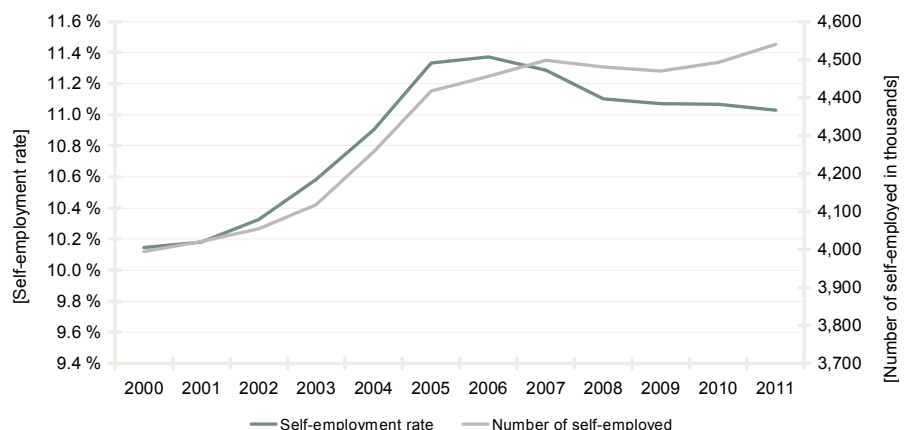
Self-employment gains ground, albeit very slowly

In Germany, interest in self-employment is greater than the percentage of entrepreneurs in the workforce would indicate. According to the findings published for the Flash Eurobarometer for Germany, 29 % of the respondents would prefer self-employment.¹ By contrast, the percentage of self-employed persons in the workforce is significantly lower and reaches only 11 %. This share increased only slightly between 1991 and 2011, by approximately two percentage points.

Half of this increase took place in the first half of the 2000's (see Chart 1). This was due in part to increased assistance for the self-employed from the Federal Employment Agency under the headword "Ich AG", or "Me, Inc.". In addition, the liberalisation of the German Trade and Crafts Code (*Handwerksordnung*) in 2004 may have facilitated the step into self-employment in the relevant economic sectors. The percentage of self-employed persons has dropped slightly again since 2006. This development is driven by an increase in the labour force. The latter trend obscures the fact that the number of self-employed workers increased in 2010 and 2011.

An increase in self-employment figures requires not only that entrepreneurs launch companies, but also that they remain self-employed. As a general observation, full-time entrepreneurs and their projects remain in the market longer. Full-time start-ups are usually larger, and thus enjoy better chances of survival. Given this isolated observation, it should be seen in a positive light when entrepreneurs opt to become self-employed on a full-time basis through correspondingly large projects.

Chart 1: Rate and level of self-employment

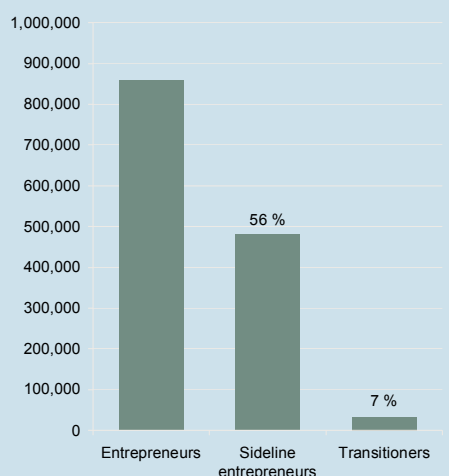


Note: Self-employment rate as the percentage of the labour force (national concept).

Source: German Council of Economic Experts, as of 28th October 2012.

Box 1: Sideline start-ups in brief

- Between 2008 and 2011 an average of approximately 860,000 people ventured self-employment.
- Of these entrepreneurs, 56 % (approximately 480,000 people) launched a sideline start-up.
- Within twelve months, approximately 7 % of sideline start-ups (approximately 34,000 people) transitioned to full-time self-employment, including
 - 52 % with employees,
 - 45 % in crafts,
 - 25 % were unemployed prior to self-employment



preneurs who remain on a sideline basis and how similar are they to full-time self-employed entrepreneurs?

Only few entrepreneurs transition between full-time and part-time self-employment

According to the present analysis of the KfW Start-Up Monitor for the years 2008 to 2011, only approximately 7 % of sideline entrepreneurs transitioned to full-time self-employment within twelve months.⁵ While this amount may appear low at first glance, past findings of the KfW Start-Up Monitor show that only 10 % of sideline entrepreneurs planned to transition to full-time self-employment within the next twelve months.⁶ Thus, it is not the case that a much larger share of entrepreneurs originally intended to transition to full-time self-employment; rather, the number of potential transitioners intending to make their move within the year is limited from the outset.

Another two reasons contribute for the limited potential for transition: First, a disproportionately high amount of sideline projects are formed for a limited term only.⁷ These entrepreneurs do not consider expanding their sideline activities to full-time self-employment from the very outset. Second, the majority of start-ups playing an active role in the economy experience little to no growth.⁸ As a result, entrepreneurs likely do not feel compelled to expand the scope of their self-employment.

Employees are the most important factor influencing transition to full-time entrepreneurship

Entrepreneurs who have employees on their payroll are significantly more likely to transition from sideline to full-time.⁹ Managing employees appears to require an effort that can only be realised on a full-time basis. At the same time, employees are an indication of larger start-up projects, which are equally likely to require greater effort on the part of the entrepreneurs. It is thus all the more likely that a sideline entrepreneur will transition to full-time self-employment.

In light of these findings, it is evident why the share of non-transitioning sideline entrepreneurs with employees is relatively low. However, it is noteworthy that

Germany's evolving working environment

Increased interest in self-employment may be fuelled by changes in the working environment which impact certain groups of people in particular. These include fewer opportunities for advancement for male employees in large companies, and a greater likelihood that low-skilled workers will switch employers or enter unemployment.² Self-employment presents itself as an option to those who lack career prospects in a company or who are seeking an alternative to unemployment.

A further indicator of changes in the working environment is the development of atypical employment. The Council of Economic Experts counts the mini-jobbers amongst this group, as well as temps and part-time employees with open-ended employment contracts. By 2011, this group accounted for 33 % of all employees – up from 18 % in 1991, although this increase had largely taken place by 2005.³ Persons in atypical employment might also have an interest in founding a sideline start-up. If the new enterprise is sufficiently successful, they may potentially expand their self-employment status to a full-time entrepreneurship.

Against this backdrop – and given the reputation Germans have for being risk averse⁴ – forming a new company on a part-time basis may have its advantages.

Sideline start-ups offer entrepreneurs the opportunity to test entrepreneurship as an employment alternative. The smaller scope of such projects on average and the correspondingly less resources that must be raised serve to limit losses in the event of failure, and thus align well with a high degree of risk aversion. Sideline projects can also be managed with limited time and effort. Thus, sideline start-up can be evaluated positively because they allow people to explore the option of self-employment.

More than half of start-ups are formed on a sideline basis

The number of sideline entrepreneurs trended downward between 2000 and 2011, mirroring the general trend for start-up activities. Nonetheless, more entrepreneurs launch start-ups on a sideline basis than on a full-time basis. Over the period observed, the share of sideline start-ups as a percentage of all entries into a self-employment remained relatively constant at an average of 56 %.

The high level of sideline entrepreneurial activity also offers significant potential for transitioners. This raises the following questions:

- How large is the transitioner group?
- Do the transitioners' projects more closely resemble full-time or sideline start-ups with constant scope?
- How are transitioners different to en-

Table 1: Characteristics of start-ups [in percent]

	Non-transitioning sideline entrepreneurs	Transi- tioners	Non- transitioning full-time entrepreneurs
With employees	24.4	52.0	38.6
With team partners	23.8	33.8	16.8
With innovative products/services	14.1	13.7	15.4
Industry			
Non-services*	15.1	36.3	18.0
Trade	16.0	17.7	17.0
Commercial services	34.0	23.9	38.1
Personal services	34.9	22.1	27.0
Occupation			
Liberal professions	33.2	15.0	29.5
Skilled crafts or trades	11.0	45.2	20.5
Other	55.9	39.8	50.0

* Includes manufacturing, construction, agriculture and forestry.

Source: KfW Start-Up Monitor 2008–2011

the amount of start-ups with employees is even higher amongst the transitioners than amongst non-transitioning full-time entrepreneurs (see Table 1). This underscores that having employees on the payroll is a driving force behind expanding the scope of a start-up.

In addition, the number of entrepreneurs founding a start-up together with team partners is disproportionately higher amongst the transitioners than amongst non-transitioning full-time entrepreneurs (see Table 1). However, the team variable does not influence the likelihood of transitioning on its own. The necessary time and resources for starting a business can be shared by the members of the team, meaning that the new start-up can well be managed on a sideline basis. Accordingly, the dimensions of the start-up projects are such that there is no pressure on team members to expand their efforts and transition to full-time self-employment.

Further project characteristics with less significance for transition

Transitioners disproportionally operate in the non-service sector (see Table 1), consisting of manufacturing, construction, agriculture and forestry. The share of transitioners in this sector is significantly higher than the share of non-transitioning entrepreneurs who launched start-ups on either a full-time or a sideline basis without subsequently changing the scope of their entrepreneurship. Correspondingly, there is a lower share of transitioners in the service sector than in the other two groups of en-

trepreneurs. However, no sector can be identified that encourages transition per se. Rather, the characteristics of entrepreneurs and their start-ups – which the sector has come to represent – are what determine whether or not a transition is made.

The concentration of transitioners in the non-service sector is also reflected in the breakdown by occupation. Approximately 45 % of transitioners work in crafts (see Table 1). A business start-up in crafts also tends to have its own significantly positive effect on the likelihood that entrepreneurs will expand the scope of their start-ups to full-time self-employment. Customer expectations as to the availability and service orientation of craftsmen, as well as project-like orders involving completion dates as seen

in the construction trade, mean that it is less likely that entrepreneurs will remain self-employed on a sideline basis over the long term.

Entrepreneurs offering innovative services or products are just as rare amongst transitioners as amongst entrepreneurs who opt not to transition from full-time to sideline self-employment or vice-versa (see Table 1). Nor does an start-up with market novelties increase the likelihood of a transition. Entrepreneurs offering innovative products or services launch their companies either as a sideline activity or on a full-time basis, without adjusting the scope of their start-up later on. It may not always be possible to launch a sideline start-up as a test phase for innovative products or services, for example when the project necessitates rapid market penetration. If market testing and customer analyses are also conducted during the pre-start-up phase, the dimensions of the project can be adapted to meet the requirements of founding an innovative company from the outset.

Entrepreneurs who launch companies out of necessity are more likely to transition to full-time self-employment

All else being equal, entrepreneurs who launch companies out of necessity are more likely to transition from sideline to full-time self-employment than are entrepreneurs who launch companies out of opportunity. If entrepreneurs lack promising prospects as dependent employees,

Table 2: Characteristics of entrepreneurs [in percent]

	Non-transitioning sideline entrepreneurs	Transitioners	Non-transitioning full-time entrepreneurs
Motivation			
Opportunity	36.5	34.7	34.5
Necessity	28.1	43.2	42.7
Other	35.4	22.1	22.8
Women	45.3	34.1	30.3
Migrational background	16.4	28.4	24.2
Age			
18–24 years	22.0	25.5	7.9
25–34 years	25.1	30.4	26.2
35–44 years	25.6	16.2	33.6
45–54 years	15.7	22.6	21.9
55–67 years	11.6	5.2	10.4
Education			
University degree	24.3	24.1	28.3
Vocational training	44.6	52.0	52.8
No degree	31.1	23.9	18.9

Source: KfW Start-Up Monitor 2008–2011

Chart 2: Labour market status prior to start-up



Source: KfW Start-Up Monitor 2008–2011

full-time entrepreneurs, and thus more closely resemble sideline entrepreneurs in this respect.

Most often, entrepreneurs have completed a vocational training or have a similar educational background. This applies in particular for non-transitioning full-time entrepreneurs, or those who transition to full-time. Non-transitioning full-time entrepreneurs are somewhat more likely to have higher educational qualifications than entrepreneurs who launch sideline start-ups. However, having reached a higher educational level does not necessarily facilitate the transition to full-time.

Transition from unemployment to self-employment increases likelihood of transition to full-time entrepreneurship

In contrast to an entrepreneur's educational level, the status in the labour market prior to entry into self-employment influences the decision to transition to full-time entrepreneurship. Sideline entrepreneurs exiting unemployment are more likely to transition to full-time than those who are employees when they launch their start-up. This is an additional motivating factor for starting a company.

Regarding the pre-start-up labour market status, transitioners are more similar to non-transitioning full-time entrepreneurs than to sideline entrepreneurs who opt not to expand their activities (see Chart 2). The latter are considerably more often inactive and more seldom unemployed at the time of the company launch.

The nature of the support measures provided by the Federal Employment Agency likely also plays a role in that regard. A prerequisite for receiving start-up subsidies beyond the first support period is that recipients must be self-employed as their primary occupation. As a result, sideline entrepreneurs seeking to leave the unemployment rolls are incentivised to expand their start-up to a full-time basis.

Conclusion

Although more people become self-employed on a part-time than on a full-time basis, this does not always mean

self-employment could well represent a potential income-generating alternative. This encourages expansion to full-time self-employment if the start-up constitutes the entrepreneurs' primary source of income.

Personal attributes have negligible influence on transition to full-time entrepreneurship

Personal attributes such as an entrepreneur's age, gender, educational or immigration background have no significant effect on the likelihood of transitioning from sideline to full-time self-employment. This finding stands in contrast to research on start-up propensity, which is significantly influenced by per-

sonal attributes.¹⁰

With respect to personal attributes, it can be seen (see Table 2) that:

- the share of women amongst transitioners is as low as the share of women amongst full-time entrepreneurs. It appears that women more often launch start-ups as a sideline activity, without there being much potential for a switch to a full-time basis.
- the share of entrepreneurs with migration background is higher amongst transitioners and full-time company founders than amongst sideline entrepreneurs.
- transitioners tend to be younger than

Box 2: Macroeconomic significance of sideline start-ups

Start-ups are subject to a wide range of expectations. In particular, they should create jobs, increase economic competitiveness and drive innovation. Given these expectations, sideline start-ups appear less interesting at first glance. They less frequently hire employees, are more often set up for a limited time period and if they introduce innovative products or services, these are mainly aimed at a regional market.

Yet even though the average sideline start-up has a smaller economic impact than the average full-time start-up, their number alone makes them significant. After all, a quarter of sideline start-ups have employees on their payroll. They enable entrepreneurs who are unemployed and economically inactive – who account for an above-average share of sideline entrepreneurs – to participate in the economic mainstream and possibly contribute to household income. Sideline start-ups are therefore important from a labour market and socio-political perspective.

Moreover, all part-time entrepreneurs can consider expanding their business activities to full-time, even if such a transition is seldom realised over the short term. It is possible that the start-up's growth potential and the options for expanding business activities will only become evident – and the transition will be accomplished – in the medium term. Overall, 25 % of sideline entrepreneurs planned to transition to full-time self-employment within 36 months.⁶

that they transition to self-employment on a full-time basis: Only a minority of sideline entrepreneurs transition to full-time.

Those who do transition include not only entrepreneurs in crafts or with employees on their payrolls, but also those who form companies out of necessity or as an alternative to unemployment. On the one hand, the incentive to transition thus arises from the start-up project itself: If the demands placed by the size of the start-up are relatively high and require a full-scale effort, it becomes necessary to take the leap towards full-time self-employment. On the other hand, there are transitioners who become self-employed due to their employment situation and who are therefore rather forced

to expand their start-up to full-time.

The advantage of a sideline start-up is that entrepreneurs can take a stab at self-employment and test out the viability of their business model. At the same time, there is the risk that start-up opportunities are not fully realised if founders limit themselves to sideline work from the outset and do not consider larger start-up projects. There is also the possibility that the start-up is too small and thus has difficulty holding its own on the market.

Transitioners are aware of these potential problems. They are considerably more likely than non-transitioners to voice reservations that their business idea might not fully mature at the time of the start-up. In addition, transitioners

more frequently have doubts as to whether it would not be more advantageous to pursue a career as a payroll employee in a company. This is because transitioners who expand into full-time self-employment may well have to abandon a secure position as a dependent employee. It is essential that this step be thoroughly considered from all angles, even after the business idea has been market tested. Nonetheless, it may be worthwhile when evaluating a business idea to think about expanding to full-time self-employment at a later date, even if the initial plan is to launch a sideline start-up. ■

¹ Vgl. European Commission (2012): Entrepreneurship in the EU and Beyond, Flash Eurobarometer No. 354.

² Vgl. Giesecke, J. (2010): Veränderte Muster. Die Entwicklung der beruflichen Mobilität seit 1984. WZB Mitteilungen No. 128, 28–30.

³ Vgl. Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung (2012), Stabile Architektur für Europa – Handlungsbedarf im Inland. Jahresgutachten 2012/13, Wiesbaden, S. 315.

⁴ Vieider, F. M., Chmura, T. and P. Martinsson (2012), Risk Attitudes, Development, and Growth, WZB Discussion Paper No. SP II 2012-401.

⁵ Estimation results for the cumulated hazard rate for transitioning from sideline to full-time entrepreneurship in the basis of the KfW Start-up Monitor survey waves 2008 to 2011. Basis for the estimation is the time period between start-up time and interview time with a maximal length of 12 months.

⁶ Vgl. Lehnert, N. (2003), Ergebnisse des DtA-Gründungsmonitors 2002, Schwerpunktthema Gründer im Voll- und Nebenerwerb. DtA, Bonn, S. 9.

⁷ Vgl. Hagen, T., Metzger, G. and K. Ullrich (2012), Boom auf dem Arbeitsmarkt dämpft Gründungsaktivität. KfW-Gründungsmonitor, KfW Bankengruppe, Frankfurt, S. 54.

⁸ Vgl. Egel, J., Fryges, H., Höwer, D., Müller B. and K. Müller (2012), Wachstumsbedingungen bzw. Wachstumshemmnisse für junge Unternehmen, Studien zum deutschen Innovationssystem, Nr. 14-2012, Berlin.

⁹ This and the following statements regarding the probability to transition from sideline to full-time entrepreneurship rely on average marginal effects of probit estimations. The dependent dummy variable has value 1 if the sideline entrepreneur has transitioned to full-time entrepreneurship at the time of the interview and the value 0 otherwise. Explanatory variables are: Gender, age, migration background, region city size, labour market status prior to start-up, educational attainment, start-up motivation, mobile phone interview, year, start-up type, industry sector, occupation, team, employees, market novelty, use of material and / or financial means.

¹⁰ Hagen, T., Metzger G. and K. Ullrich (2012): Boom auf dem Arbeitsmarkt dämpft Gründungsaktivität. KfW-Gründungsmonitor, KfW Bankengruppe, Frankfurt.